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Canada. Royal commission on banking and finance  
Hearings v. 50-52, Briefs v. 45A-47A. 1962

1964



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# Royal Commission on Banking and Finance

PROFESSOR PAUL A. SAMUELSON

Hearings  
held at

OTTAWA

Vol.

50

Date.

October 19, 1962



Official Reporters  
J. J. Pethercut and R. J. Young  
Toronto, Ont.







ROYAL COMMISSION ON BANKING Ontario,  
Friday,  
October 19, 1962.

AND FINANCE

--- At 8.45 A.M. the hearing resumed.

SUBMISSION OF

Hearings held at Ottawa,  
Ontario, on Friday,  
October 19th, 1962.

THE CHAIRMAN: - This morning we have a  
submission from Professor Paul Samuelson, Professor  
of Economics, from the Massachusetts Institute of

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Technology and formerly adviser to the United States

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Investment Dealer  
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.  
Banker  
Toronto, Ontario

Mr. Gordon L. Harrold  
Agriculturalist  
Calgary, Alberta

Mr. Paul H. Leman  
Corporation Executive  
Montreal, Quebec

Mr. John C. MacKeen  
Corporation Executive  
Halifax, Nova Scotia

Dr. W. A. Mackintosh  
Vice-Chancellor  
Queen's University  
Kingston, Ontario

Mr. H. A. Hampson - Secretary  
Mr. Gilles Mercure - Joint Secretary



Minister of Finance  
Ottawa, Ontario

- 6216 -

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of Economics, from the Massachusetts Institute of  
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It is a great pleasure to have you present  
with us this morning, Dr. Samuelson. We look forward  
very much to the discussion which will ensue, and in  
spite of the late arrival of the brief we have had an  
opportunity of reading it and had some discussion on  
it last evening, and we look forward to the discussion  
here this morning with great interest.

It is not necessary, as a rule, for a witness  
to make any preliminary statement unless he wishes  
to do so; having read the brief, it is unnecessary  
to summarize it for us. The various points will  
develop as we go on and the viewpoints that you think  
should be mentioned are entirely, of course, in your  
hands. If it suits you, we will now proceed.

Are there any questions?

COMMISSIONER LEMAN: Dr. Samuelson, I have  
read your memo, although I can't claim to say I really  
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1 forgive me if I ask questions that you may feel were  
2 answered in your memo. I may have missed some as I  
3 went through it.

4 Also, if you don't mind, I would like to  
5 change the order of this a little bit because I have  
6 a bent for talking about objectives before discussing  
7 the means of achieving them, so I would like to start  
8 on this question of the objectives and the conflict of  
9 objectives.

10 You seem to make a case here for making sure  
11 that in this discussion on conflicts of objectives that  
12 no one gets hypnotized by any one of them and makes  
13 too much of a sacrifice to achieve them, et cetera;  
14 however, in setting up a central bank there has to be  
15 some kind of a legislative authority for its constitution  
16 and the way it should operate. Do you have a fairly  
17 clear view yourself of what should be the official  
18 statutory objectives set before a body which is called  
19 a central bank?

20 PROFESSOR SAMUELSON: May I first say in  
21 a perfunctory way that I am speaking throughout all  
22 this simply as a professor of economics without any  
23 official capacity.

24 Secondly, the Chairman was kind enough to  
25 call my submission a brief. It is very lengthy and  
26 came very late, and I apologize for that. If I had  
27 had time I would have written a shorter paper.

28 With respect to objectives, most central  
29 banks in the world were fortunate that they were  
30 born in a fit of absent-mindedness and didn't



1 forgot to ask you if I had questions that you may feel were  
2 answered in your mind. I may have missed some as I  
3 went through it.

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5 change the order of this a little bit because I want  
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7 the means of achieving them, as I would like to start  
8 on this question of the objectives and the attainment of  
9 objectives.

10 You seem to make a case here for making sure  
11 that in this discussion on objectives of objectives that  
12 no one gets hypnotized by any one of chemical names  
13 too much of a scientific, to achieve them, of research  
14 however, in setting up a central bank there has to be  
15 some kind of a legislative authority for its creation  
16 and the way it should operate. Do you have a fairly  
17 clear view yourself of what should be the official  
18 statutory objectives set before a body which is called  
19 a central bank?

20 PROFESSOR SAMUELSON: May I first say in  
21 a gentlemanly way that I am speaking through you, and  
22 this simply as a professor of economics without any  
23 official capacity.

24 Secondly, the Chairman was kind enough to  
25 call my submission a paper. It is very laudatory and  
26 some very large, and I apologize for that. If I had  
27 had time I would have written a shorter paper.  
28 With respect to objectives, as an economist  
29 besides in the world were fortunate that they were  
30 born in a fit of absent-mindedness and illness



1 require constitutional instructions in the beginning.  
2 The Bank of England didn't start out as a central  
3 bank, but if one were to set out explicitly to put  
4 down the ground rules for a central bank, my feeling  
5 is that the instructions should be general rather than  
6 specific.

7 This comes out of the actual economic analysis  
8 in my submission, having to do with automatic rules.  
9 How nice it would be if the mechanism of economics were  
10 such that a lawyer drawing up the papers for a central  
11 bank could be given explicit instructions which he  
12 could put into the constitution of the central bank,  
13 so that the public would be entitled to know at future  
14 dates whether the officials of the organization had  
15 properly been carrying out their mandate. To my mind  
16 this, however desirable, isn't possible in any detail  
17 because of the economics of the situation, and I would  
18 refer to the similar problem of the Employment Act of  
19 1946 in the United States.

20 This was a pivotal piece of legislation,  
21 which went through our Congress after very much  
22 discussion. The official wording is of an extremely  
23 abstract and general sort: that it is the intention of  
24 the government to secure the maximum of purchasing power,  
25 employment, and quite a number of the other good things  
26 of life. (They seem to have forgotten price stability  
27 at that time and it has been suggested that it be  
28 amended). Now in response to your question it must be  
29 evident that men of good will could do quite different  
30 things and each still say that he was within the



...the constitutional restrictions in the legislation.  
The Bank of England didn't stand out as a central  
bank, but if one were to set out explicitly to  
show the ground rules for a central bank, my feeling  
is that the international character of the central bank is

This comes out of the central bank's history

is my impression, having to do with a central bank.  
Now, it would be in the position of a central bank  
and that a central bank is the basis for a central  
bank would be given explicit recognition which he  
could put into the constitution of the central bank.  
So that the public would be entitled to know in advance  
dated within the limits of the organization and  
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of life. (They seem to have forgotten price stability  
at that time and it has been suggested that it be  
included). Now in response to your question it must be  
evident that men of good will would be able to find  
things and even still say that it was within the



1 framework of the mandate of that legislation. So I  
2 would say that if I as a drafter had to put in a list  
3 of things which it was the duty of the central bank to  
4 watch, I would make sure that it was a long list or  
5 a very general list, and not highly specific.

6 For example, it would have been a tragedy  
7 if in the Federal Reserve Act of 1913 there had been  
8 highly specific instructions embodying the best  
9 judgment of the legislators and economists and bankers  
10 at that time, because the behavior of the Federal Reserve  
11 System has been almost opposite to that intended by  
12 the founders of the 1913 Act. The founders of that  
13 Act thought it was a most important thing to have an  
14 elastic currency, one which would automatically expand  
15 every time farmers, merchants and industrialists  
16 needed money.

17 In fact, Governor Strong, one of our great  
18 central bankers, the Governor of the New York Federal  
19 Reserve Bank, and the man who dominated the 1920's  
20 discovered in actual operation the whole device of  
21 open market operations; and there would have been  
22 nothing, I daresay, in the 1913 charter, if it had  
23 tried to be specific, which would have empowered the  
24 Federal Reserve to use open market operations, which  
25 I think would have been detrimental.

26 Now, we all have a way of getting out of our  
27 own way and Acts do come to be modified, but I don't  
28 like strict constitutional jackets in economic affairs  
29 if they can be avoided. That is a personal opinion.  
30



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In fact, Governor Strong, one of our great central bankers, the Governor of the New York Federal Reserve Bank, and the man who dominated the 1920's discovered in actual operation the whole device of open market operations; and there would have been nothing, I dare say, in the 1913 charter, if it had tried to be specific, which would have empowered the Federal Reserve to use open market operations, which I think would have been detrimental.

Now, we all have a way of getting out of a own way and Acts do come to be modified, but I don't like strict constitutional jackets in economic affairs if they can be avoided. That is a personal opinion.





1 COMMISSIONER LEMAN: But it seems to me  
2 that in your memo when you move from what you call  
3 the economics and objectives and begin to narrow  
4 down a little bit on this to some specific responsi-  
5 bilities in the monetary policy field, you seem to come  
6 back pretty well to a mix of the objectives which are  
7 the maximum utilization of all resources, growth and  
8 price stability and a good balance between these three.  
9 These are still the most recognizable objectives, are  
10 they not?

11 PROFESSOR SAMUELSON: Yes.

12 COMMISSIONER LEMAN: Now, you make a  
13 distinction there in Section 16 of your brief where  
14 you talk about stocks of money and near money being  
15 mostly the result of monetary action and flows of  
16 income being more pertinent to, say, fiscal policy.  
17 I was very much interested in that distinction. Do  
18 you believe that the areas that are concerned with  
19 stocks, that all the areas concerned with stocks of  
20 money and near money are clearly identifiable and in  
21 this case that one can think of reorganizing the  
22 various institutional authorities to say, "Well, we  
23 will have one that will deal with stocks everywhere  
24 where they are concerned, and we will have another  
25 that will be interested in the flow"?

26 PROFESSOR SAMUELSON: First I would say,  
27 as in all empirical phenomena, one thing shifts into  
28 another and there are certain problems of identifying  
29 boundaries. There are certain operations which are  
30 clearly of the stock asset and not of the flow type;

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PROFESSOR SAMUELSON: Yes.

COMMISSIONER LEVINE: Now, you make a distinction here in Section 16 of your order where you talk about stocks of money and near money and mostly the result of monetary action and flows of income being more pertinent to, say, fiscal policy. I was very much interested in that distinction. Do you believe that the areas that are concerned with stocks, that all the areas concerned with stocks of money and near money are clearly identifiable and in this case that one can think of reorganizing the various institutional authorities to say, "Well, we will have one that will deal with stocks everywhere where they are concerned, and we will have another that will be interested in the flow?"

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as in all empirical phenomena, one thing shifts into another and there are certain problems of identifying boundaries. There are certain operations which are



1 this is the accounting distinction between a balance  
2 sheet and a profit and loss or income flow statement.  
3 There are other operations and transactions which seem  
4 to be on the borderline.

5 In making the distinction between stock  
6 analysis, I want to warn at least the American readers  
7 that it is not equity stocks which are being discussed  
8 here. In making this distinction I am merely trying  
9 to determine what, after all, is monetary and credit  
10 policy as against fiscal policy. However, I don't  
11 necessarily deduce from this that the central bank is  
12 to be the exclusive agency which handles stocks and  
13 that the treasury, is to be the exclusive agent which  
14 handles flows.

15 Now, I refer to Dr. Holtrop's submission  
16 to you, which I have had the opportunity of reading.  
17 He puts it very correctly, I think, that debt  
18 management is without doubt part of stock rather than  
19 flow, and yet in his country -- and I may say in my  
20 country too -- the responsibility for debt management  
21 is not with the central bank. I myself would like to  
22 see a much closer co-ordination between conventional  
23 central bank monetary policy and debt management; and  
24 I can imagine certain arguments being made for having  
25 the central bank do the debt management; or having the  
26 central bank within the government itself, doing its  
27 central banking policies and debt management there.  
28 But I don't think that I would regard my analytical  
29 distinction as a good reason for throwing all stock  
30 operations altogether in a new constitutional





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1 specification.

2 COMMISSIONER LEMAN: You do still seem to  
3 favour some separation of responsibilities between  
4 treasury and the monetary authority, do you not,  
5 although they have common objectives? You do feel  
6 there should be a reasonably clear separation of  
7 responsibility?

8 PROFESSOR SAMUELSON: I incline in that  
9 direction for historical reasons; the institution  
10 of central banking grew up in this way. I think that  
11 you pay a price if you move too fast away from the  
12 actual pattern of development. But, as I mentioned,  
13 in looking ahead 25 years I believe that the  
14 independence of the central bank is much less today  
15 than it was earlier and will be much less in the  
16 future. Yet I think there may be certain minor  
17 advantages in still keeping the central bank as a  
18 distinct entity.

19 COMMISSIONER LEMAN: Well, perhaps that is  
20 a too simple approach to the problem of organization,  
21 but it seems to me that if one leaves things a little  
22 too blurred as to responsibility, you end up with  
23 about fifteen cooks trying to stir the same sauce,  
24 and I think that we get afraid of that situation and  
25 that is why I was asking if you think this notion of  
26 stocks against flows in general would be a better  
27 line of demarcation.

28 PROFESSOR SAMUELSON: Yes, I would say that  
29 if you could look upon this purely as an engineering  
30 problem and not have the traditions and human emotions



COMMISSIONER LEWIS: You do still seem to

favor some separation of responsibilities between

industry and the monetary authority, do you not?

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but it seems to me that if one leaves things a little

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and I think that we get tired of that somewhat and

that is why I was asking if you think this system

stands against flows in general would be a better

kind of organization.

PROFESSOR SAMUELSON: Yes, I would say that

in the world look upon this largely as an engineering

problem and not have the traditional and common view of





1 and certain democratic pressures of the moment, in  
2 principle I would like to see these things unified.

3 Lord Cobbold made a very picturesque  
4 reference in his statement to you. He imagined an  
5 automobile, and he said that it is not a good thing  
6 to have one person with his foot on the brake pedal  
7 and another person with his foot on the accelerator  
8 pedal. I think the image could be sharpened even  
9 more in the field of debt management. It is a problem  
10 of two people fighting for the steering wheel. The  
11 car is being driven with the Federal Reserve having  
12 its hand on the steering wheel and the treasury with  
13 its hand on the steering wheel. When those two people  
14 are sweethearts and close friends this may work out  
15 very well. But when there is friction, and there has  
16 been friction -- I am not now referring to any specific  
17 incident in my own country, but any student of the  
18 problem could give you half a dozen cases of extreme  
19 friction, -- this is very bad. It is a case of pull  
20 Able and pull Baker.

21 I will give you an example of this.  
22 Australia had a crisis in the 1930's between the  
23 central bank and its government and the former was  
24 economically wrong. (I want to make it clear that  
25 in most of these cases it is wrong to concentrate  
26 on the Treasury with a capital "T". It is a problem  
27 in my country of the executive branch of government as  
28 against the central bank. The problem in a cabinet  
29 system of government will show itself in different  
30 form, but in every case there can arise a conflict



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against the central bank. The problem is a conflict

system of government will show itself in different

form, but in every case there can arise a conflict



1 between the government and the central bank.)

2 May I give another illustration. This is  
3 one of not quite such ancient history.

4 In the Truman administration there came a  
5 time of discord between the Federal Reserve Board and  
6 the President; and the Treasury as I recall insisted  
7 upon floating some short-term bills at rates lower  
8 than the Federal Reserve Board thought were proper.  
9 The Federal Reserve Board -- I don't remember the  
10 details and if I have some of them wrong my point may  
11 still be valid -- the Federal Reserve Board said  
12 "All right, you may issue them". What they then did  
13 was to take them completely off the market; and since  
14 the Fed. is in the 100 per cent excess profits  
15 bracket it was just as though the Treasury had not  
16 accomplished its purpose at all. I do not think that  
17 is a good way to run a railroad, though it is a way  
18 of dramatizing and bringing to the public the conflicts  
19 of opinion which people in high authority have.

20 COMMISSIONER LEMAN: Well, Professor  
21 Samuelson, in your Section 13, beginning on page 28  
22 you suggest that if there was a similar commission  
23 to this one sitting 25 years from now, the list of  
24 topics that they would be emphasizing in their  
25 discussions would be quite different from what it  
26 is today. Is that just an expression of confidence  
27 on your part that this question of independence of  
28 the central bank will be clearer in everybody's mind  
29 in 25 years, or does it go further than that? Is  
30 it your confidence that this business of conflict





between the Government and the central bank.  
Now I give another illustration. This is

one of our public law number 100.

In the Government administration there came a

time of discord between the Federal Reserve Board and

the President, and the Treasury as I recall, suggested

upon issuing some short-term bills at 100 per cent

when the Federal Reserve Board thought were proper.

The Federal Reserve Board -- I don't remember the

details and if I have some of them would my points may

still be valid -- the Federal Reserve Board said

"All right, you may issue them". What they then did

was to take them completely off the market and then

the bill, is in the 100 per cent excess profits

protest it was that as though the Treasury had not

accepted its purpose at all. I do not think that

is a good way to run a national bank. It is a way

of domesticating and obliging to the public the bank

the opinion which people in high authority have.

Samuelson, in your Section 12, beginning on page 26

you suggest that if there was a similar illustration

to this one at least 25 years from now, the first of

things that they would be negotiating in 1950

illustrations would be quite different from what it

is today. Is that just an expression of your opinion

on your part that this question of independence of

the central bank will be a factor in development in 1950

in 25 years, or does it go further back than that? Is

it your confidence that this business is going to



1 of objectives and harm that can result from, let  
2 us say, a certain amount of inflation; price inflation  
3 et cetera, will also become a lot clearer in every-  
4 body's mind in 25 years?

5 PROFESSOR SAMUELSON: I think it is  
6 primarily a reflection of the historical fact, which  
7 is perhaps not an accident, that the central banks  
8 of the world have felt themselves to be a minority  
9 group, more preoccupied with the problem of price  
10 stability than the elected parliaments of the world;  
11 and that in a sense they have had their heels dug in  
12 against inflation. I should not say it is a last  
13 ditch fight because it will go on for a long, long  
14 time, but in the privacy of their boudoirs when they  
15 look into their own hearts they say to themselves:  
16 "In the good old days there was greater integrity  
17 all around and there was greater independence of the  
18 central bank, and there just is not that now, though  
19 we are still fighting what we regard as the good  
20 fight".

21 I think there is a definite trend toward  
22 curbing the independence of central banks. Read the  
23 Radcliffe Report, the Japanese Inquiry, and the American  
24 Commission on Money and Credit. Any one of those  
25 would be shocking to the central bankers of the past,  
26 such as Governor Strong. In that sense I read the  
27 trend of the times; and it happens not to be the one  
28 that I would disapprove of as they would.

29 COMMISSIONER LEMAN: Well, I was trying  
30 to read into it, perhaps, the prediction on your part



of objectives and aims that are really true, for  
us say, a certain amount of inflation; price inflation  
of course, will also become a lot clearer in every-  
body's mind in 32 years.

THOMAS SAMUELSON: I think it is  
in general not an accident, that the central banks  
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of vision, because it will go on for a long, long  
time, but in the privacy of their positions when they  
look into their own hearts they say to themselves  
"In the good old days there was greater loyalty  
and honour and there was greater independence of the  
central bank, and there just is not that now. Through  
we are still fighting what we regard as the good  
fight."

I think there is a definite trend towards  
curbing the independence of central banks, and for  
Responsible Budgets, the Japanese Budget, and the American  
Commission on Money and Finance. Any one of these  
would be working to the central control of the  
such as Governor Strong. In that sense I need not  
fear of the future and it appears now to be the  
that I would disapprove of as they would.

THOMAS SAMUELSON: Well, I am not  
to put it in it, perhaps, the central bank, but



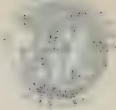


1 that inflation will not be, during the next 25 years,  
2 an acute problem that our economies will be watching  
3 for?

4 PROFESSOR SAMUELSON: I had intended no  
5 such notion.

6 COMMISSIONER LEMAN: Well, if I might home  
7 in a little bit on this question of price stability,  
8 it seems to me you feel that this whole question can  
9 be exaggerated in peoples minds. In other words,  
10 that one should not be too dogmatic and say we must  
11 have absolute stability; one should not even say  
12 we should have a gradual deflation, and perhaps if  
13 it looks as though there is building in a very slow  
14 price inflation, well then leave that because you can  
15 compensate that with various -- I would not call them  
16 gimmicks, but various off-setting factors that the  
17 government can watch over. Then you seem to say  
18 that there are two types of price inflations that  
19 should be feared. You refer to the cost-push one  
20 and then the type of run-away inflation which may  
21 stem from what you call either wars or social dis-  
22 organization. As far as the first one is concerned,  
23 the cost-push type, what is your fundamental reason  
24 for saying that is the one to fear? Is it because  
25 it can become the run-away, or because it is a  
26 particularly bad kind of inflation?

27 PROFESSOR SAMUELSON: I had hoped to write  
28 a section of some considerable length on the problem  
29 of a "seller's" or "cost-push" inflation as against  
30 a "demand-pull" inflation. Unfortunately the clock



last time when I was here, during the year 1935.

PROFESSOR SAMUELSON: I had intended to

such action.

in a little bit of this question of price stability.  
It seems to me you feel that this whole business can  
be brought about in a better way. In other words,  
that we should not be too dogmatic and say we want  
have absolute stability; we should not have any  
we should have a gradual adjustment, and perhaps if  
it looks as though there is nothing in a very long  
or the inflation, well, then leave that because you can  
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that there are two forms of price inflation that  
should be feared. You refer to the too fast one  
and then the type of two-way inflation which may  
come from what you call either wars or other things  
organization. As far as the first one is concerned,  
the two-way type, what is your fundamental reason  
for saying that is the one to fear? Is it because  
it can become the one-way, or because it is  
unavoidably bad kind of inflation?

PROFESSOR SAMUELSON: I don't know what

a section of some considerable part of the economy  
to a "section" of "section" inflation as such as  
a "section" of inflation, inflation in the



1 ran out on me and that did not get written, so I  
2 welcome the opportunity of saying some words about it.

3 For countries like the United States,  
4 Canada, and the U.K. I am not concerned about the  
5 galloping inflations of the type we have had dramatically  
6 in the past. The proto-type for my generation was the  
7 post World War I German inflation from 1920 to 1923,  
8 in which the income from a life, expressed in German  
9 marks, would in the end not buy a package of cigarettes  
10 or even one cigarette. Throughout history inflations  
11 like that have occurred and they are still occurring,  
12 for instance, after World War II in China and Hungary  
13 and a number of places.

14 I am not concerned about astronomical  
15 inflation, not because I do not understand that it is  
16 a horrible thing -- it is a horrible thing -- but  
17 because it is not a threat to our democratic society.  
18 In particular I do not think it inevitable that a  
19 very gentle price rise will go from a creep to a lope,  
20 then from a lope to a trot, until you are finally in  
21 such galloping inflation. Very few of the dramatic  
22 ones started in that way. I do not think there is  
23 any reason to worry about that. I worry about a  
24 cost-push inflation because there is some evidence  
25 that, in the institutions of a modern democratic  
26 mixed enterprise economy, there is a tendency for  
27 costs and prices to rise long before unemployment is  
28 at a minimal level, and long before excess capacity  
29 has disappeared. It is remarkably sad how few  
30 countries of our type have had in the post-war world





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1 simultaneously high employment and price stability.

2 In the case of my own country in the post-  
3 war there was a brief period, just prior to 1953,  
4 when we had both of those happy conditions; but they  
5 are very rare. So I worry about cost-push, not because  
6 it is the most dreadful danger one can imagine, but  
7 because it is the most relevant one.

8 The second reason I worry about it is that  
9 it is the hardest thing to handle by fiscal and monetary  
10 policy. I want to emphasize that it is as much a  
11 problem for fiscal policy as it is for central bank  
12 policy. I devoted a number of pages of my submission  
13 to the question as to whether the central bank had  
14 some peculiar way of affecting the price level factor  
15 in the P times Q relationship, and I concluded it had  
16 no such power. It is as much a problem for fiscal  
17 policy as for the central bank.

18 Now, if you have the old-fashioned demand-  
19 pull inflation, there arises primarily a problem of  
20 dosage. My old teacher of economics in Chicago,  
21 Professor Paul H. Douglas, who went on to become a  
22 Senator has dramatized demand-pull inflation in  
23 Congressional hearings and over the T.V. in the  
24 following way. Here is this glass partly filled with  
25 water. There at the top is the full employment or  
26 high employment point. If you look at that glass you  
27 see that there is not enough money spending to achieve  
28 the full potential amount of goods. Therefore the  
29 Treasury or the central bank looks at its many weapons  
30 for extending purchasing power, in order to fill the

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1 glass fully. And it is a matter of dosage. It adds  
2 water in this way -- just about up to the lip.

3           Everybody recognizes that when you try to  
4 define the exact point of full employment you are in  
5 trouble, and there is a problem as you get very near  
6 it. Most believe it is just a little bit below the  
7 rim of the glass. What would happen if it were all  
8 just a question of demand-pull inflation? I am not  
9 going to be as dramatic as Senator Douglas, but he  
10 adds even more water than I am doing, and then you  
11 see the water overflowing on to the table, depicting  
12 demand-pull inflation in action. He would then insist  
13 that all the central bank and fiscal authorities have  
14 to do is reduce the amount of aggregate spending. They  
15 can reduce this in a variety of ways, not all  
16 equivalent, but each designed to accomplish the  
17 purpose. You can run a larger surplus by an increased  
18 tax rate; or you can reduce the amount of money by  
19 open market sales of securities. Or you can raise  
20 the discount rate and change the legally required  
21 reserve ratios of the banks. You then bring the  
22 water down to this correct level. So it is a very  
23 badly mismanaged economy that has extensive trouble  
24 if only demand-pull mechanisms are involved.

25           In the case of a cost-push inflation, even  
26 when the employment index is way down, and there  
27 still seems to be excess capacity, you find a tendency  
28 for the water to overflow and for prices to rise.  
29 I think this is best dramatized for the economists  
30 by what has come to be called the Phillips Curve.

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2 Economics wrote an article in Economica some few  
3 years ago which gave rise to very considerable notice,  
4 criticism and discussion. It was a historical study  
5 of the relationship between the degree of unemployment  
6 in Britain's economy and the rate of price rise or  
7 wage rise.

8           A very nice Phillips Curve that permits  
9 only the demand-pull inflation would be one with the  
10 comfortable property that until you get down to low  
11 unemployment rates there is no steady pressure from  
12 the supply and cost side for prices to rise. Then the  
13 old demand-pull analysis would be very adequate.  
14 Unfortunately, a very nice kind of Phillips curve  
15 is not the kind experienced in the United Kingdom and  
16 Sweden, and a number of other modern economic systems.  
17 Instead the realistic Phillips curve has a way of  
18 showing price increases at times of considerable  
19 unemployment -- higher I would say for the United  
20 States than for many countries, but perhaps there is  
21 some similarity between Canada and the United States.  
22 I would not want to comment on that since I have not  
23 studied that question in Canada.

24           This creates a tremendous dilemma for the  
25 fiscal and monetary authorities because it is no  
26 longer a matter of dosage. In an extreme case, if  
27 you refuse to give in to the price rise, you create  
28 unemployment. Now, it would be a happy situation  
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1 sellers in the economy; we could then go right back  
2 to a nice Phillips curve again. Although this action  
3 creates unemployment, it might be regarded as an  
4 investment in success. And it would involve only a  
5 little slack in the system. I think this is called  
6 Parishism in the United Kingdom after Professor Parish  
7 of the London school: that is, a policy of  
8 deliberately creating a little slack so as to get  
9 rid of this bad cost push. But it is not clear that  
10 this would work out nicely in the experience of the  
11 United States.

12 Chairman Martin of the Board of Governors  
13 of the Federal Reserve once asked in Congress the  
14 question: "Suppose there is an element of cost-  
15 push, does that mean the central bank should be less  
16 restrictive or more restrictive?" He did not pause  
17 for an answer, but I thought that his own opinion  
18 was perhaps indicated in the context -- namely, that  
19 the attempt to stabilize prices is all the more  
20 important in a cost-push situation. I must confess my  
21 doubts. In my opinion, it is a real dilemma. In  
22 certain circumstances you will find yourself, I think,  
23 as the good pragmatic decision-maker, giving in a  
24 little along the price line, compromising with evil,  
25 tolerating some slight amount of increase.

26 I want to emphasize that it is never the  
27 business of the Governor of the central bank to say  
28 publicly: "I am a realist. I know that one must  
29 compromise with evil and must tolerate a price  
30 increase." In season and out of season he must

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1 preach against it in his public statements. I do not  
2 mean that there is a double standard of morality.  
3 What I mean is that public statements are construed  
4 in a different way from private opinions and beliefs.

5 Yet I think it would be a tragedy in many  
6 modern economies if a dogmatic central banker, brought  
7 up in an earlier tradition, in a position of insulated  
8 power, on the basis of his pragmatic feeling as to  
9 how this conflict of goal should be decided, were for  
10 a considerable number of years to be permitted to  
11 pursue his policy.

12 That would be a tragedy for a variety of  
13 reasons, including the fact that money policy would be  
14 by-passed. Here Lord Cobbold's image of the brake  
15 pedal comes in. We find the spectacle of the central  
16 banks of the world using high interest rate policy  
17 in order to check loose fiscal policies of governments.  
18 You may say that you have accomplished the same purpose  
19 in terms of controlling effective demand, and perhaps  
20 you have; but what you have done is loaded the dice  
21 against growth. You have loaded the dice in favor of  
22 current consumption spending, and put most of the  
23 pressure on investment and net capital formation  
24 spending. That is all very well if people are in a  
25 Galbraithian mood and do not want growth, but I do  
26 not see any evidence of that in the hypothetical  
27 situation I am mentioning. I see only evidence that  
28 the central banker is inflexible and a vestige from  
29 an earlier time, when perhaps the Phillips curve of  
30 the world behaved in the nicer way that you might

proceed against it in his public statements. I do not mean that there is a double standard of morality. What I mean is that public statements are constructed in a different way from private opinions and beliefs. Yet I think it would be a tragedy in many modern economies if a dogmatic central banker, brought up in an earlier tradition, in a position of insulated power, on the basis of his pragmatic feeling as to how this conflict of goal should be decided, were for a considerable number of years to be permitted to pursue this policy.

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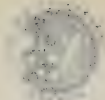
1 dream of.

2 COMMISSIONER LEMAN: Professor Samuelson,  
3 would you just clarify one point which came up as you  
4 were talking. Do you really feel, therefore, that  
5 a situation where there is possible inflation clearly  
6 recognizable -- and let us say clearly recognizable --  
7 because there is not what one would consider an  
8 acceptable growth rate in the economy, and there is  
9 no reasonable employment of resources, you are then  
10 facing a true break-down of what we know as a market  
11 economy operation?

12 PROFESSOR SAMUELSON: I think "break-down"  
13 is too strong a word. But I do think that you are  
14 facing a dilemma in which a perfectionist will become  
15 somewhat disillusioned with controls of aggregate  
16 demand and free markets. I think Mr. Sproul in his  
17 excellent submission before you, which I have had the  
18 opportunity to read, hinted at that when he said that  
19 one must not rely too much on monetary policy; and  
20 I think I would add in this context that one must not  
21 rely too much on fiscal policy. One must look for  
22 new mechanisms which will ameliorate sellers'  
23 inflation problems. I should like to add that I have  
24 no constructive suggestions in this area. This is an  
25 area of the most perplexing kind.

26 I once not completely humorously went on  
27 record as saying that smarter men than I would have  
28 to find a solution to this problem. That was some  
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1 which took place recently in the United States. I  
2 have no opinion whether that was, on balance, a good  
3 thing to have done before the fact. I do not have an  
4 opinion whether on balance that was a good thing to  
5 have done after the fact. Certainly any great  
6 enthusiast who thought such kinds of intervention would  
7 solve the Sproul dilemma, received no great amount of  
8 comfort from the incident. But the ingenuity of free  
9 democratic societies may develop new mechanisms.

10 In that sense, rather than use the word  
11 "break-down" I would speak of a "dilemma". The  
12 Commission on Money and Credits in the United States,  
13 in the course of their deliberations, became more aware  
14 of this problem. In their final report they showed  
15 considerable unease about this. As a zealot would  
16 say, they sacrificed the important goal of absolute  
17 price stability. A pragmatist might say that they  
18 recognized some of the facts of life and showed the  
19 need not to be dogmatic about any one objective in  
20 a situation where there is conflict and there is a  
21 trade-off between objectives.

22 COMMISSIONER LEMAN: This discrepancy which  
23 exists in the situation where you have wholesale  
24 prices reasonably stable and yet consumer prices  
25 keep on creeping up, say by one per cent, despite the  
26 stability of the wholesale prices, is a form of cost-  
27 push inflation, is it not?

28 PROFESSOR SAMUELSON: I think not  
29 necessarily. I made some comments in my paper on the  
30 interpretation of the official indexes. We had a



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1 committee set up at the request of the U.S. government  
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5 economists had already suspected, it is quite  
6 impossible to make due allowance for quality changes,  
7 so that a one per cent increase in the reported  
8 consumer price index, given a margin of error  
9 involved in all these things plus this conceptual  
10 error of definition, could be quite compatible with  
11 a true price index showing no increase at all. In  
12 that sense, for the moderate figures you have given I  
13 would say that there is no particular indication  
14 of a cost-push.

15 Now, I want to add that in the realm of  
16 services we have shown less productivity improvement  
17 even after you have corrected matters for quality  
18 changes. Yet many of the service markets, from the  
19 labour viewpoint, are more competitive than are the  
20 goods markets. So, that kind of cost-push which  
21 we relate to unilateral union pressure, organized  
22 labour, union official pressure, and to administered  
23 prices by corporations alleged to be possessed of  
24 some degree of market power, is peculiarly absent  
25 from the services field. Yet they are the fields  
26 which show a very considerable increase in prices.

27 Now, you could put it in this way.  
28 Consider the fields which show no productivity  
29 improvement, like the services field -- and I may  
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Now, I want to add that in the realm of services we have shown less productivity improvement even after you have corrected matters for quality changes. Yet many of the service markets, from the labour viewpoint, are more competitive than are the goods markets. So, that kind of cost-push which we relate to unilateral union pressure, organized labour, union official pressure, and to administered prices by corporations alleged to be possessed of some degree of market power, is peculiarly absent from the services field. Yet they are the fields which show a very considerable increase in prices.

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1 economics and I teach to about the same number of  
2 people in the same bumbling way as I did twenty years  
3 ago, with the result that college tuition has been one  
4 of the most explosive items in the cost of living  
5 index and will continue to be so. You may say that  
6 in the absence of any cost-push in a really ideal  
7 flexible world, the corporate sector which produces  
8 goods and has a considerable improvement factor in  
9 productivity ought to have a massive reduction in  
10 prices. No, scratch out the word "massive"; they  
11 ought to have a considerable reduction in prices.  
12 So that overall prices would average out to approximate  
13 stability, or to barely a one per cent increase.

14 That is asking quite a lot of a modern  
15 industrial society, although in the realm of  
16 agriculture, when government does not intervene for  
17 the purpose of changing the free market allocation  
18 of income, you often do get just such price  
19 reductions large enough to outweigh the price rises  
20 in the service industries.

21 COMMISSIONER GIBSON: Professor Samuelson,  
22 perhaps I might ask a question arising out of your  
23 remarks. Do the problems in connection with controlling  
24 or reducing the cost-push inflation lead your thinking  
25 in the direction of the development of some wages  
26 policy or administrative price policy? Is that the  
27 way in which you see a solution, or do you see any  
28 light in that at all?

29 PROFESSOR SAMUELSON: It suggests to me a  
30 ground for seeking such a solution, but I am not saying



economies and I teach to about the same number of people in the same bumbling way as I did twenty years ago, with the result that college tuition has been one of the most explosive items in the cost of living index and will continue to be so. You may say that in the absence of any cost-push in a really ideal flexible world, the corporate sector which produces goods and has a considerable improvement factor in productivity ought to have a massive reduction in prices. No, scratch out the word "massive"; they ought to have a considerable reduction in prices. So that overall prices would average out to approximately stability, or to barely a one per cent increase. That is saying quite a lot of a modern industrial society, although in the realm of agriculture, when government does not intervene for the purpose of changing the free market allocation of resources, the price rises reductions large enough to outweigh the price rises in the service industries.

perhaps I might ask a question arising out of your remarks. Do the problems in connection with controlling or reducing the cost-push inflation lead your thinking in the direction of the development of some wages policy or administrative price policy? Is that the way in which you see a solution, or do you see any light in that at all?

PROFESSOR SAMUELSON: It suggests to me a ground for seeking such a solution, but I am not saying



1 that any of the suggested solutions of which I have  
2 heard are likely to solve the problem. I even think  
3 of many of them that they might do more harm than  
4 good. I would not regard the dilemma as a  
5 malignant disease; but it is a problem.

6 To use the image of medicine, if you  
7 diagnose a disease and sense the need for a cure for  
8 it, but you have not anywhere in the laboratories  
9 such a cure, then that is like the state of my mind  
10 with respect to this problem.

11 COMMISSIONER GIBSON: We have had suggested  
12 to us that if monetary fiscal policies are reasonably  
13 strong in the next decade, say, in view of the outer  
14 balance of productive forces in the world and closer  
15 balance between demand and supply, this might become  
16 less of a problem provided there is no additional  
17 strain in the way of overdoing monetary and fiscal  
18 expansion. Is that sensible?

19 PROFESSOR SAMUELSON: I think it is possible.  
20 Do you remember Mr. Micawber who was always waiting  
21 for something to turn up? I think we can occasionally  
22 wait for something to turn down. Per Jacobsson, a  
23 prophet not without honour, has said that we are  
24 facing a new era of deflation at the moment. We have  
25 certainly seen this in the important realm of staples.  
26 Colin Clark predicted that in 1960, after the war,  
27 there would be a massive increase in the prices of  
28 primary products. He said that terms of trade would  
29 move a great deal in their favour; he predicted that  
30 in 1943 or 1942, if I remember. Right after the war



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1 things did go his way, but at the half-way mark to  
2 1960 they turned the other way to a great degree.

3 One thing about the terms of trade between  
4 primary products and others is that they do fluctuate.  
5 There are long-term tides in the affairs of man, so  
6 that with a little luck the problem of cost-push or of  
7 mild secular inflation could become less of a tension.

8 If I may give a concrete example, in the  
9 United States we have just been in rather a happy state  
10 if you look only at the price index. For the last  
11 couple of years the wholesale price index has been  
12 levelling off, if not falling. The increase in  
13 consumer prices has been quite moderate. But this  
14 does not re-assure me in the slightest, because  
15 although I will not say we have<sup>been</sup>/in a major depression,  
16 we have been running at too low pressure.

17 By running the American economy in a  
18 sluggish way -- and I do not mean in the sense of  
19 mild Paishism, which says in Britain that the  
20 unemployment rate should go from  $1\frac{1}{2}$  per cent to  
21 2 per cent -- at 7 or 6 per cent unemployment, you  
22 will not have the same cost-push. But that is no  
23 way to run a railroad either.

24 COMMISSION GIBSON: That is; the cure is  
25 worse than the disease in this case?

26 PROFESSOR SAMUELSON: In some measure that  
27 is true, I think.

28 COMMISSIONER BROWN: Professor Samuelson,  
29 you did make a remark in your observations that  
30 Paishism would not work in the United States. Is that

things did go his way, but at the half-way mark to 1930 they turned the other way to a great degree.

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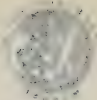


1 because of some rigidities in the economy, or what?

2 PROFESSOR SAMUELSON: It would be a very  
3 long story to try to analyse the mechanism of what  
4 I have called cost-push. I think I prefer the  
5 expression "sellers' inflation" as against "demand  
6 inflation" because that suggests the responsibility  
7 is broadened. I think it is naive to attribute cost-  
8 push simply to organized labour. It is very  
9 understandable that unions will try to get an  
10 increase in money wage rates, and that union leaders  
11 will try to get such an increase; but it is naive  
12 to think that leaders push and that the rank and file  
13 do not push. The late Professor Slichter, an  
14 intimate student of unions, said that union leaders  
15 lost their jobs more often through a vociferous  
16 minority in the rank and file who think that the  
17 leaders are not being active, than because they are  
18 too active. Sellers' inflation is a phenomenon  
19 which also involves management. The Phillips curve  
20 is not merely a reflection of labor push. There is  
21 involved not only the unions but also the weak or  
22 strong resistance of management, and sometimes it  
23 looks almost as if unions are pushing against an open  
24 door in these matters.

25 More than that, let me give you an example  
26 in the educational field. At M.I.T. my secretary  
27 is not a member of a union. I do not think there is  
28 any particular danger (if that is the right word) that  
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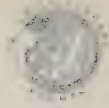
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1 increase along with everybody else. If you ask why  
2 we pay more, it is because otherwise the quality of our  
3 people will gradually diminish in recruitment, and  
4 so forth. If I buy a pair of shoes and I put them on,  
5 the shoes give me service as a piece of leather. But  
6 in the case of a wage, the service you get depends on  
7 what you pay. If you do not increase wages and labour  
8 is made unhappy, you may actually lose in terms of  
9 cost. All in all this tendency toward sellers'  
10 inflation and cost-push is rather deep and widespread  
11 in our system, even involving some of the best aspects  
12 of our system.

13 Take, for example, unemployment compen-  
14 sation. Very few men of good will think such  
15 improvements are bad. But it is a fact that Paishism,  
16 at least in the extreme degree, depends on a change  
17 in people's attitudes because they are out of work,  
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1                    COMMISSIONER LEMAN: Professor Samuelson,  
2                    I should like to go back to your refusal to call it a  
3                    break-down of the market economy. Perhaps the word  
4                    was a little strong, but it is a symptom of the  
5                    system of balances that we count on in a market  
6                    economy not working in that case, is it not?

7                    PROFESSOR SAMUELSON: Yes.

8                    COMMISSIONER LEMAN: I meant break-down  
9                    in that sense.

10                  PROFESSOR SAMUELSON: Yes.

11                  THE CHAIRMAN: There is one point to  
12                  which I should like to come back for a moment. You  
13                  were discussing friction which arises on occasion  
14                  between the central bank and perhaps Congress, or  
15                  some other public body of that kind. I suppose that  
16                  it is not a unique situation in central banking. Is  
17                  it not the conflict which arises so often in this  
18                  world between the experts and the amateurs? You have  
19                  the central bank, which is a body of highly trained  
20                  men in a very specialized profession; on the other  
21                  hand, you have legislators, some of whom may be  
22                  experts, but no doubt most of them are not experts  
23                  in this particular field, and there is always a  
24                  conflict. I do not know whether there is such a  
25                  thing as a formula for resolving the situation, but  
26                  it is something with which we have to live, is it not?

27                  PROFESSOR SAMUELSON: I think that the  
28                  whole political process can be expected to involve  
29                  certain adversary procedures and differences of  
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7 are almost always the conflict between those who  
8 want more expansion and those who want less. It is  
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10 internal and the external value of the currency, and  
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6 Had I not heard about this case and had somebody  
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9 I think I would have made a pretty accurate guess as  
10 to who was on which side. So, it is a special kind  
11 of conflict.

12 I do not know how you define an expert, but  
13 if you would be kind enough to include a person like  
14 myself as an expert ---

15 THE CHAIRMAN: Oh, yes.

16 PROFESSOR SAMUELSON: In doing so you  
17 would blanket in quite a number of academic economists.

18 THE CHAIRMAN: You might include me as an  
19 amateur.

20 PROFESSOR SAMUELSON: Taking the fashion  
21 of academic economists as it is now in the United  
22 States I think it is fair to say that those of us  
23 experts who have a Freudian love for the Federal  
24 Reserve and think of it and henpeck it all the  
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1 improvement, that there is a chance of much improvement  
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4 PROFESSOR SAMUELSON: I think that these  
5 things go in cycles, and I detect a little improvement.  
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7 "Populist" philosophy is very dominant in legislatures  
8 you have the greatest friction. At a time when that  
9 particular philosophy is not rampant in the electorate  
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11 Mr. Dooley said that the United States  
12 Supreme Court follows the election returns. That is  
13 a joke. It is somewhat true that the central bankers  
14 of the world also follow the election returns.

15 Montagu Norman -- and he is one of the  
16 last who had quite a lot of unilateral power --  
17 thought he had the right to nag; in fact he had the  
18 duty to nag and he had the right to protest, and  
19 publicly protest. I have now ceased to quote him,  
20 but he also had the right, which every public servant  
21 has, of resigning in a huff and with a blast. I  
22 think that is a very important right. It is a right,  
23 by the way, which any civil servant has, and which a  
24 political figure within government has. If I were  
25 drawing up a constitution I would put in some specific  
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2 a rule in that central bankers be prohibited from  
3 holding any money assets or any near-money assets at  
4 all.

5                   PROFESSOR SAMUELSON: Are you thinking of  
6 conflict of interest in the person himself?

7                   COMMISSIONER LEMAN: Well, he might have  
8 a bias.

9                   PROFESSOR SAMUELSON: I do not think that  
10 is really a serious problem, but we have a rule,  
11 as you know, that the Secretary of the Treasury cannot  
12 hold government bonds. He is the only man in the  
13 United States who is not personally allowed to hold  
14 any government bonds. We also have a rule for  
15 government officials that sometimes they must not  
16 control common stocks. I will be somewhat facetious,  
17 but instead of getting out of common stocks perhaps  
18 they should be made to get into a balanced mutual  
19 fund so that they would remain part of the human  
20 race. That would be a more neutral state for them  
21 to be in than holding only money or gilt-edge type  
22 of instruments.

23                   COMMISSIONER LEMAN: I was not being too  
24 serious myself with that question.

25                   COMMISSIONER GIBSON: I should like to  
26 ask Professor Samuelson a few questions about the  
27 effectiveness of monetary policy and how it works.  
28 You say at the beginning of your memorandum that it  
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1 to point out that a monetary policy is more effective  
2 in some circumstances than in others. You point out  
3 that when it is used vigorously in a restrictive sense  
4 it can be very effective and possibly too effective  
5 at times. You also point out that there is the  
6 difficulty, when it is being used for restrictive  
7 purposes, that a little may not have much effect, but  
8 that after a while it will suddenly take.

9           You also make it clear on the other side  
10 that it may be very difficult for a monetary policy  
11 to be effective in real depression conditions. What  
12 I am wondering is how you think it actually works?  
13 Does it work through interest rates, and what parts  
14 of the economy does it particularly affect?

15           PROFESSOR SAMUELSON: I had intended to  
16 have a whole section on that subject with headings  
17 such as Open Market Operations, Discounting Operations  
18 and Reserve Ratios, but again the clock and my  
19 schedule did not permit me to get to that. Therefore,  
20 I would be glad to give my views on the subject.

21           First, may I say with respect to one  
22 aspect of the question you asked, namely, whether a  
23 little-money monetary policy does not have much  
24 effect but a bigger one can create catasmic effects,  
25 that was not my opinion. What I mentioned was that  
26 such a view could not be dismissed as illogical and  
27 impossible, but in point of fact I do not think that  
28 has been our experience. I do not want, therefore,  
29 to press that as my view; indeed I wish to express  
30 some skepticism about it.





to point out that a monetary policy is more effective in some circumstances than in others. You point out that when it is used vigorously in a restrictive sense it can be very effective and possibly too effective at times. You also point out that there is the difficulty, when it is being used for restrictive purposes, that a little may not have much effect, but that after a while it will suddenly take.

You also make it clear on the other side that it may be very difficult for a monetary policy to be effective in real depression conditions. What I am wondering is how you think it actually works? Does it work through interest rates, and what parts of the economy does it particularly affect?

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have a whole section on that subject with headings such as Open Market Operations, Discounting Operations and Reserve Ratios, but again the clock and my schedule did not permit me to get to that. Therefore, I would be glad to give my views on the subject.

First, may I say with respect to one aspect of the question you asked, namely, whether a little-money monetary policy does not have much

effect but a bigger one can create catamorphic effects, that was not my opinion. What I mentioned was that such a view could not be dismissed as illogical and impossible, but in point of fact I do not think that has been our experience. I do not want, therefore, to press that as my view; indeed I wish to express some skepticism about it.



1                   When I speak of conventional monetary  
2 policy, I have in mind primarily the open market  
3 operations, which for the American economy is the  
4 important weapon. I also think it is the important  
5 weapon for the British economy, although in the  
6 British economy it is aborted to some extent by the  
7 discounting facilities that are available. I do not  
8 wish in the presence of experts on the Canadian scene  
9 to say anything about the Canadian situation because  
10 of my ignorance. This particular set of operations  
11 is primarily, important because it affects the  
12 interest rate structure and the availability of credit.

13                   It has a secondary importance which I do  
14 not want to belittle because it also affects the  
15 valuation of assets. When interest rates are high the  
16 price you can get for the real assets you already own  
17 is low, you feel poorer and you will consume less;  
18 and, as a businessman, you are less liquid and  
19 less free to invest. Its primary function is the  
20 effect it has on the terms of trade between the  
21 investment of a reserve and the return of that  
22 reserve in fruit at some later date. By the  
23 "interest rate" in this context I do not mean simply  
24 the bill rate, I mean the rate on gilt-edge long-term  
25 government securities.

26                   The profit rates which businessmen would  
27 seek, and which they will often insist upon getting,  
28 are not in the order of magnitude of 2.9 per cent,  
29 even though in the New York money market at this  
30 time the bill rate is about 2.9 per cent. They



Library  
of Congress

That I have no objection to the

admission of the bill to the committee

and to the consideration of the same

by the committee on the subject

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1 may be on a before-tax basis for a certain kind of  
2 corporation, 12 per cent. However, it is an empirical  
3 fact that when you engineer a bill rate of 2.9 per  
4 cent as against 4.9 per cent, the effective profit  
5 rate which businessmen will have to get may go from  
6 12 per cent to 18 per cent. I think if you were to  
7 interrogate businessmen you would often get denials  
8 on this. But my experience in talking to businessmen  
9 and looking at the figures and in thinking about how  
10 I would react in their shoes, suggests to me a lot of  
11 things that pay at 12 per cent just do not pay at 20  
12 per cent. The argument which I must fight against  
13 is very familiar to me because I myself at various  
14 stages in my life have believed in it to a considerable  
15 degree, namely, "Well, what is the effective interest  
16 rate on anything?" As a consumer it does not matter  
17 to me what the interest rate is, and I spend about  
18 the same fraction of my income independently of it.

19           Some people would take the following view:  
20 With respect to business, for very short-term assets,  
21 the interest is not a very great cost. For very  
22 long-term assets -- and I am almost quoting directly  
23 the words of Professor J. R. Hicks of Oxford University  
24 -- the uncertainty is so dominant that the interest  
25 rate washes out. That leaves you a razor's edge  
26 of something that is between a long-term risk  
27 investment and a short-term investment, and you cannot  
28 do much operating on a razor's edge. I think that  
29 view is pretty substantially correct with respect  
30 to a short-term carrying of inventories.







1 Sir Ralph Hawtrey, one of the most renowned experts  
2 in our age on monetary policy and central banking,  
3 has always insisted that there exists somebody  
4 called the trader, one who carries interest on money.  
5 This chap is a very shiftable fellow as to the amount  
6 of inventory he will hold, depending on expectations  
7 of interest rates and the actual interest rates. I  
8 cannot profess to be an expert on the English  
9 countryside but I cannot find this fellow in the  
10 American countryside.

11 But often a businessman is concerned  
12 because he cannot get adequate bank credit and finance  
13 at the going rate. And such credit availability, or  
14 unavailability, is correlated with movements in the  
15 interest rate structure.

16 I think for long-term investments the  
17 factor of uncertainty is very important, but it is  
18 quite wrong to think that it washes out the interest  
19 rate factor. I have studied a great number of  
20 prospectuses of toll roads and bridges and it makes  
21 all the difference in the world, particularly for  
22 the promoter, whether he can make a million dollars  
23 if the capital that is available to him is available  
24 at, let us say, an 8 per cent rate or whether as  
25 a promoter the capital is available to him only at  
26 a 20 per cent rate. It may seem shocking to talk  
27 about 20 per cent rates, but if one reads the Wall  
28 Street Journal very carefully and follows the  
29 fortunes of companies like -- well, perhaps I  
30 should not name any particular names -- one will find







1 that some companies which build our biggest sky-  
2 scrapers and grandiose hotel projects are paying  
3 20 per cent rates for money in many periods. You  
4 have got to be awfully smart and have an awfully  
5 good deal to be able to make money when you are  
6 paying off your borrowed money at 20 per cent.

7 So far as productive investment is  
8 concerned, I think that the longer the run that takes  
9 place the more you will get a choking off of invest-  
10 ment at high interest rates, and a coaxing out of  
11 investment at low rates.

12 As I qualified myself in my paper -- you  
13 must remember that I am a professor, after all, so  
14 I do qualify my remarks -- there are deep depression  
15 times when there is not much potency in conventional  
16 monetary policy in either direction. I do not think  
17 we are in those times most of the time. One of the  
18 greatest challenges, I think, to the American system --  
19 and here is where the central bank will have direct  
20 responsibility -- is to find means whereby we can get  
21 a deepening of capital. Can we move from projects  
22 that promise a 30 per cent return down to projects  
23 that promise a 20 per cent return, down to projects  
24 that promise a 15 per cent return, if that is the  
25 way the wind is blowing and technological change is  
26 not throwing up 30 per cent projects? We have  
27 to ask ourselves that question because in our kind  
28 of capitalistic system we want to behave well, not  
29 only in the sunny weather but also when the sun is  
30 not shining. I do think we need to get business







1 concerns to set their sights down lower and lower.  
2 They do gradually learn from experience, and they know  
3 that rather than sitting on their hands they should  
4 do something, and that it is better to get an 8 per  
5 cent return than to get no return at all.

6 I think it is here that the central bank  
7 has a great role to play in monetary policy. I have  
8 not commented on credit availability ---

9 COMMISSIONER GIBSON: Before you go on to  
10 that may I ask if you think that gradual changes in  
11 interest rates of modest proportions upward or down-  
12 ward have a fairly wide effect on long-term investment  
13 decisions, or is it a pretty narrow margin that these  
14 changes work in?

15 PROFESSOR SAMUELSON: I think that gradual  
16 changes in interest rates have gradual effects on  
17 investment over a fairly wide area, but the degree  
18 of those gradual changes increases with the time that  
19 is allowed to elapse. The width of the effect also  
20 becomes greater in time.

21 In saying this I do not mean to suggest  
22 that you can expect an increase in interest rates to  
23 affect every activity in the same way. Housing  
24 interests will come to our Congress when money gets  
25 tight and say: "We are affected more than the  
26 wholesale drug trade, and that is unfair". I will  
27 not agree with that. It would be wrong to think  
28 the purpose of an interest rate policy is to cause  
29 a one per cent reduction in everything, because at  
30 a lower rate of interest certain changes in the



...and they view

They do gradually learn from experience, and they view  
that rather than sitting on their hands they should  
do something, and that it is better to err on the side  
of doing something than to sit on their hands at all.

I think it is better that the central bank  
has a good idea of what the monetary policy is. I have  
not commented on credit availability ---

COMPTROLLER IN CHARGE: I think you are on the  
right way. I am not sure that the monetary changes in  
the last few years of monetary expansion have been  
very good. I think the effect of the monetary expansion  
has been to create a lot of inflation. I think that is  
not good. I think that is a mistake. I think that is  
a mistake. I think that is a mistake.

CHIEF OF BUREAU: I think that is a mistake.  
I think that is a mistake. I think that is a mistake.  
I think that is a mistake. I think that is a mistake.  
I think that is a mistake. I think that is a mistake.  
I think that is a mistake. I think that is a mistake.  
I think that is a mistake. I think that is a mistake.

In saying this I do not mean to suggest  
that you can expect an increase in interest rates to  
affect every activity in the same way. However,  
interest will come to our Government when money is  
tight and says: "We are interested more than the  
whole is that time, and that is unfair". I will  
not agree with that. It would be wrong to think  
the purpose of an interest rate policy is to cause  
a one per cent reduction in everything, because as  
I think that is a mistake. I think that is a mistake.





1 composition of the economy are what are required for  
2 efficiency, and to fill the needs of the public.

3 COMMISSIONER GIBSON: In other words,  
4 you say there is more doubt about a long-range  
5 decision and, therefore, more reason why it should  
6 be postponed for the time being?

7 PROFESSOR SAMUELSON: Yes, and even in a  
8 world of certainty a high interest rate is an  
9 indication that society is not in a position to lock  
10 up its resources for 50-year periods as against  
11 25-year periods. A country like India should by  
12 no means think it should produce houses of the  
13 durability of houses in the United States, because  
14 that country has a different capital scarcity. Times  
15 of great capital stringency (for example immediately  
16 post-war), when a lot of things ought to be done,  
17 then probably schools -- and I am thinking of schools  
18 in Cambridge, Massachussetts, and where I live in  
19 Belmont, Massachussetts -- ought to be portable  
20 schools; they ought to be temporary structures with  
21 some of the disadvantages that that implies. Later  
22 on, when society, so to speak, gives the go-ahead  
23 signal to deepen its capital, these inadequacies can  
24 be corrected.

25 The interest rate structure, including  
26 the imperfections of society that create the  
27 availability, is an appropriate signalling device.  
28 Although it is wise it is not perfectly wise.

29 COMMISSIONER GIBSON: And it is not  
30 discriminatory, in a sense?





consideration of the company and what are required for  
efficiency, and to tell the needs of the public.  
GIVEN: THESE THINGS: IN OTHER WORDS,

you are to have a more direct and a more  
decision and, therefore, more reason why it should  
be produced for the time being.

THESE THINGS: YES, AND EVEN IN A  
world of constant change, the interest must be in

industrial and social to get a better picture of  
the situation for future action in business.

THESE THINGS: A better idea of the situation  
as shown which is shown in the future of the

possibility of success in the future of the  
business and a different social picture.

THESE THINGS: (THESE THINGS) (THESE THINGS) (THESE THINGS)  
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1 PROFESSOR SAMUELSON: The English language  
2 is very interesting. "Indiscriminate" and "dis-  
3 criminatory" come from the same root, and one sounds  
4 bad and the other sounds bad in the opposite sense.  
5 I would say this is a discriminate thing. It is  
6 not arbitrarily discriminatory.

7 Now, in the short run, given our market  
8 imperfections, there are special problems associated  
9 with the availability of capital to large business  
10 as against small business, and perhaps what is of  
11 more importance is the availability of capital to  
12 established business, whether it be small or large,  
13 as against the availability of capital to new business.  
14 Even that is not completely arbitrarily discriminatory  
15 because when capital is very scarce -- I am speaking  
16 metaphorically -- society cannot take risks with  
17 respect to untried projects that it could properly  
18 take at another time. So, part of that discrimination  
19 is discriminate, but it is not arbitrarily dis-  
20 criminating.

21 COMMISSIONER GIBSON: That is very  
22 interesting. Would you like to go on to the question  
23 of availability of funds?

24 PROFESSOR SAMUELSON: Yes. With respect  
25 to the availability of credit I think that that is  
26 an important mechanism in the short run. I ought,  
27 though, to say that I have testified before  
28 Congress at some length on this subject, and in that  
29 testimony I have pooh-poohed the notion that it is  
30 only through credit availability that interest rates work.



UNITED STATES DEPARTMENT OF THE INTERIOR  
BUREAU OF LAND MANAGEMENT  
WASHINGTON, D. C.

MEMORANDUM FOR THE SECRETARY, DEPARTMENT OF THE INTERIOR

SUBJECT: *[Illegible]*

Reference is made to your letter of *[illegible]* and the Bureau's

and the other Bureau in the same line.

I would say that it is a desirable thing. It is

not entirely satisfactory.

Now, in the same line, it is not

entirely satisfactory, but it is not

with the utilization of capital to issue business

as against other business, and business

is not in the same line of capital to

established business, whether it be small or large.

It is not the same line of capital to use in

fact that it is not completely satisfactory.

Because when capital is used, it is not

entirely satisfactory -- it is not

entirely satisfactory, but it is not

entirely satisfactory. It is not

entirely satisfactory, but it is not

entirely satisfactory.

THE SECRETARY, DEPARTMENT OF THE INTERIOR

REFERENCE: Would you like to go on to the question

of availability of funds?

THE SECRETARY, DEPARTMENT OF THE INTERIOR

to the availability of funds I think that there is

an important question in the same line. I think

enough to say that I have testified before

concerned at some point on this subject, and in that

testimony I have emphasized the fact that it is

not entirely satisfactory that interest payments





1 I will supply your secretariat with the proper  
2 reference if you would like me to do so. But  
3 in the short run I think it is an important  
4 mechanism.

5 It works in this way. In my country  
6 it is very common for a commercial bank to have  
7 an interest rate of 6 per cent on a commercial loan.  
8 That will hold good without variation for three  
9 years, or maybe ten years or fifteen years. It  
10 will also hold as between a very substantial and  
11 reliable company and a less tried and true company.

12 If you then look for the effect of Federal  
13 Reserve policy on the interest rates charged to  
14 borrowers you might be excused for thinking that  
15 there was no effect -- that the rate was always 6  
16 per cent. But if you go below the surface you will  
17 realize that there are compensating balances which  
18 are required from different companies, and in  
19 different degrees. If the Federal Reserve engineers  
20 a tightness of the bill rate from 2 per cent to  
21 4 per cent, the chances are that a borrower in the  
22 Boston area, who had to keep only a 10 per cent  
23 compensating balance previously, will now be asked  
24 to keep a 30 per cent compensating balance. The  
25 true cost, of course, of the borrowing is 6 per cent  
26 on the whole sum, but how much of it do you have free  
27 to use for yourself? If you have to keep a 50  
28 per cent compensating balance then the interest rate  
29 would be equal to 12 per cent per annum. There are  
30 many devices of that sort that are concealed, and yet





I will supply your account with the proper  
reference to you would like me to do so. And  
in the event that I think it is an important

it would be wise to do so.

It is very common for a commercial bank to have  
an interest rate of 6 per cent on a commercial loan.  
And this rate is not unusual for a bank to have.  
And it is very common for a bank to have a 6 per cent  
interest rate on a commercial loan.

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And it is very common for a bank to have a 6 per cent

interest rate on a commercial loan.

And it is very common for a bank to have a 6 per cent



1 there is not a simple rationing. It is rather like  
2 the auction market in that you do not see the true  
3 price.

4 We do not have in my country the custom  
5 of having rates geared to the discount rate so that  
6 the Federal Reserve can automatically on one day,  
7 by changing its discount rate, change the terms  
8 charged by the banks to a wide number of borrowers.  
9 We have a man-made device which is a private  
10 enterprise device, and that is the so-called prime  
11 rate.

12 I think a number of customers find  
13 themselves in a certain relationship to the prime  
14 rate. The prime rate is a cartel-like rate set up  
15 by the principal banks for the so-called best  
16 borrowers. Even it is a signalling device, but it  
17 is variable because at certain times my medium-  
18 sized successful company will be a member of the  
19 club and will be able to borrow at the prime rate,  
20 but when money is more stringent I might find out  
21 that I am not a charter member of the club and I  
22 no longer qualify for the prime rate. It is a  
23 complicated system.

24 We have the commercial paper market, and  
25 when the banks are being very sticky, and are out of  
26 tune with the market, companies will go into the  
27 commercial paper market, where the rate is very much  
28 like an auction rate.

29 All in all, I would argue that there are  
30 in the short run very substantial and dramatic effects



— 75 —





1 from credit rationing, or the availability of credit.  
2 The longer the run for a certain period the more  
3 these things merge into actual pecuniary charges,  
4 so it is more as if the rate were going up. There  
5 is a certain amount of unevenness in the process and  
6 I think certain things could be done about it; but  
7 the principal mechanism, I think, operates through the  
8 whole interest rate structure.

9 COMMISSIONER GIBSON: But, so far as the  
10 effect of monetary stringency on inventories is  
11 concerned you would say that that would work more  
12 through availability or more through actual changes  
13 in the cost of money?

14 PROFESSOR SAMUELSON: I would say that  
15 so far as inventories are concerned it probably  
16 would be more related to availability.

17 There is another factor. I cannot call  
18 it moral suasion, but it is the sort of thing that  
19 applies typically to a small business or a medium-  
20 sized business when it is in a certain relationship  
21 with a banker. That business gets advice from the  
22 banker, and much of that advice is like the advice  
23 received from an uncle. You can take it or leave it.  
24 But, the fact is, that bankers supply money and when  
25 you, a car dealer, let us say, are told: "We are  
26 going to drop the boom on you if you keep this  
27 number of cars", you jolly well begin to discount  
28 your cars and order less. There is that sort of  
29 suasion factor which is backed up by a certain  
30 amount of economic power, and I think it is quite







1 important.

2 COMMISSIONER GIBSON: In other words,  
3 bankers' views about expectations are transmitted in  
4 a fairly effective way?

5 PROFESSOR SAMUELSON: Yes, including the  
6 banker's view of the leanness of his liquidity  
7 position, which the Federal Reserve has direct means  
8 of affecting.

9 COMMISSIONER GIBSON: How much do you think  
10 these reactions work on expectations rather than  
11 immediate effects?

12 In other words, when interest rates go  
13 up, or in one way or another the cost of getting  
14 money goes up a bit, and money becomes a little  
15 harder to get, is it just this that causes people  
16 to change their views a little, or do they say that  
17 this means a different economic environment, perhaps,  
18 and it is a signal that money may be harder to get?

19 PROFESSOR SAMUELSON: I think in the very  
20 short run there are significant announcement effects  
21 of changes by the authorities which change the  
22 expectations of the participants in the economic  
23 scene, and which could have important effects. But,  
24 I think many of the economists of my generation tend  
25 to exaggerate the expectation effect.

26 I will call your attention to the review  
27 by Professor J. Gurley of the Radcliffe Report in  
28 the American Economic Review. In fact, I made  
29 reference to it in my submission. One of the things  
30 he pokes a little fun at is that the Radcliffe Report



From evidence to exhibit 8





1 took much too seriously the view that expectations  
2 and intentions are what cause changes rather than  
3 real actions. It is rather like the Mikado: when  
4 he said a man was to be executed it was as good as  
5 done, and therefore it was done. My view is that  
6 you do actually have to change the amount of  
7 liquidity in the system.

8 I think that announcements affect  
9 expectations if people have learned that these are  
10 the correct signals of changes in the actual avail-  
11 ability of funds, and they anticipate them a little  
12 bit; but let the central bank start making  
13 announcements which it does not follow through,  
14 then it will be like King Canute and the tide.  
15 You can tell the tide what to do but it will pay  
16 no attention to you. People will soon learn not  
17 to pay attention to your announcements.

18 I do not think that it is a sort of  
19 bootstrap operation, that by making people think  
20 monetary policy is going to be tight they will act  
21 as though it is tight, and you do not really have  
22 to tighten it at all. You can catch them once on  
23 that sort of operation, perhaps, but not repeatedly.

24 COMMISSIONER GIBSON: We have had it  
25 suggested to us that in some other countries -- not  
26 the United States-- it is only major and striking  
27 changes in monetary policy that have much effect on  
28 the business community's attitude, and that these  
29 small changes edging this way and that way have  
30 comparatively little effect. Does this make sense





and intentions are what cause changes rather than  
real actions. It is water like the Minado: when  
he said a man was to be executed it was as good as  
done, and therefore it was done. My view is that  
not so actually have to change the amount of  
liquidity in the system.

I think that the Committee should  
concentrate on the fact that the amount of  
the correct amount of changes in the amount of  
liquidity of money, and they anticipate them a little  
bit; but for the central bank to make  
announcements which it does not follow through,  
then it will be like the King George and the lion.  
You can tell the tide what to do but it will pay  
no attention to you. People will soon learn not  
to pay attention to what the central bank says.

I do not think that it is a good idea  
to keep the question, that by making people think  
monetary policy is going to be tight they will not  
as though it is tight, and you do not really have  
to tighten it at all. You can catch them once on  
that sort of operation, perhaps, but not repeatedly.

COMMISSIONER BISHOP: We have had in  
suggested to us that in some other countries -- not  
the United States -- it is only major and striking  
changes in monetary policy that have much effect on  
the business community's attitude, and that these  
small changes doing this way and that way have  
very little effect. Does this make sense



1 from the standpoint of the United States, in your  
2 thinking?

3 PROFESSOR SAMUELSON: I think that the  
4 accumulation of small effects does not dissipate the  
5 effect. I do not believe, in other words, in the  
6 threshold phenomenon -- that if you sprayed paint  
7 a little drop at a time all over this table you  
8 will not even see the difference. What you will  
9 see is over a great expanse a very thin difference  
10 everywhere.

11 I am of the opinion, though, that the  
12 zealots for monetary policy, particularly those who  
13 argued against credit when the Federal Reserve was  
14 trying to get its freedom, are wrong when they say  
15 that when you let the price of bonds get to \$97  
16 you have got the tight monetary policy you want.  
17 I think the evidence is against that. It is not  
18 that there is any optical illusion. If I could  
19 lapse into my academic manner and draw a curve  
20 of the relationship of the degree of monetary  
21 policy to its degree of effectiveness you would  
22 see that it is not that there are threshold effects  
23 but that there are corners in the curve, and  
24 discontinuities. It is rather that the curve has  
25 a substantial slope, and it takes a considerable  
26 interest rate change to have a considerable effect.  
27 You do not have great effects from small things.  
28 Technically speaking, you do not have an infinite  
29 and real elasticity of response in your functions  
30 and schedules and diagrams to the effects of



92.52-117.89

and sent him to the HOLY TRUTH ROBERTSON



Nethercut & Young

Toronto, Ontario

- 6262 -

1 spending activity by various changes in the level  
2 of central banking activity. Even at the best of  
3 times I do not think you have that sort of effect.

4  
5 --- Short recess.





SECRET

spending activity in various changes in the level  
of central banking activity. Even as the best of  
times, it is not possible to have a steady state.

--- 2nd round.

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1 THE CHAIRMAN: We shall now resume.  
2 Mr. Gibson?

3 COMMISSIONER GIBSON: Mr. Chairman, when  
4 we broke off Prof. Samuelson made a number of  
5 interesting comments about how monetary policy works  
6 or how changing credit in monetary conditions works,  
7 and he left me with the impression that the consumer  
8 isn't very much affected in this pattern and particularly  
9 that long-range investment decisions and, to some  
10 extent, the inventory decisions, were the operative  
11 parts of this phenomenon.

12 If this is fair, I would like to go on  
13 and ask you how you think attitudes and views about  
14 liquidity affects spending decisions? This is  
15 another way of talking about the same thing, really,  
16 but we have heard a lot of broad liquidity concepts  
17 since the Radcliffe Report and I wonder if you would  
18 care to say a bit about how you think people view  
19 this question and if it does affect their spending  
20 decisions?

21 PROFESSOR SAMUELSON: May I first say that  
22 the consumer, as house owner and owner, is quite  
23 considerably affected by credit, but as a purchaser  
24 of cigarettes and breakfast foods and even of  
25 washing machines he is probably not so importantly  
26 affected. The state of liquidity is an important  
27 variable, I believe, for investment decisions, and  
28 therefore it is important. I think that the central  
29 bank when it sticks to conventional operations is,  
30 to some degree, altering the distribution of liquidity



we know it. That, however, made a number of  
 the people concerned about the matter very active  
 on the subject and it is a very serious matter.  
 and he felt no with the situation that the company  
 could very well be in a position and position  
 that long-range investment decisions and, no more  
 extent, the investment decisions, and the objective  
 of this investment.  
 In this is that, I would like to go on  
 and ask you how you think the situation and view  
 the situation is. The situation is that this is  
 another way of looking at the same thing, really,  
 but we have heard a lot of other things, I suppose  
 since the situation is that I would like you would  
 like to get a new view and you think people view  
 the situation and it is a very serious matter.  
 I think that is the situation.  
 I think that is the situation. Now, I first saw this  
 the company, as some other and over, is quite  
 considerably affected by credit, but as a publisher  
 of cigarettes and breakfast foods and even of  
 washing machines he is probably not so importantly  
 affected. The case of liquidity is an important  
 variable, I believe, for investment decisions, and  
 therefore it is important. I think that the central  
 bank when it starts to conventional operations is,  
 to some degree, altering the distribution of liquidity





1 rather than changing its total.

2 For example, if you confine yourself to

3 the most conventional of central banking operations,

4 which is the purchase of a short-term government

5 security, like a 90-day instrument, the central bank

6 is merely putting out cash and taking in a near

7 money substitute. The total of liquidity is probably

8 affected, but it is not affected substantially. If

9 the central bank were very unconventional -- which

10 I am not suggesting here -- and dropped money from

11 aeroplanes, aside from any interest rate effect,

12 there would be a very substantial effect upon

13 liquidity and upon the asset structure and that would

14 show itself in operations. If this could be expected

15 to be a repetitive act, I would almost transfer it

16 to the area of flows rather than stocks, because each

17 person would total up his income and say that you

18 could haul around a certain amount of money as a

19 labourer or that I will get my dividend cheque

20 by mail or by manna from heaven, and this would

21 have very substantial effects. But the conventional

22 thing which the central bank does is exchange one

23 kind of asset for another.

24 A reserve ratio change, which can have a

25 very potent and dramatic effect in the United States

26 is used only at infrequent intervals, and that can

27 have a strong effect upon liquidity. I included,

28 therefore, in my interest rate effects, which I

29 enlarged upon earlier, a certain amount of these

30 liquidity effects, because it is by affecting the





FRANK D. WHITE

For example, if you confine yourself to  
the most conventional of central banking operations,  
which is the business of a short-term government  
security, I've a 90-day instrument, the central bank  
is merely putting out cash and taking in a near  
money instrument. The central bank is merely  
extended, but it is not without substantiality. It  
the central bank were very unorthodox -- which  
I am now suggesting here -- and dropped money from  
retirement, raising from any interest rate effect,  
there would be a very significant effect upon  
liquidity and upon the entire structure and that would  
show itself in operations. If this could be expanded  
to be a permanent act, I would almost transfer it  
to the area of fixed income and stocks, because each  
person would turn up the income and say that you  
could have a certain amount of money as a  
substitute for that I will get my dividend savings  
by mail or by means from interest, and this would  
have very substantial effects. But the conventional  
thing which the central bank does is exchange one  
kind of asset for another.  
A reserve and no change, which can have a  
very potent and drastic effect in the United States  
is used only as independent interest, and that can  
have a strong effect upon liquidity. I included,  
therefore, in my interest rate effect, which I  
enjoyed upon either, a certain amount of those  
liquidity effects which are in operation.



1 stocks of different assets or, if you like, the  
2 liquidity position of the community, that these  
3 interest rate changes take place in the market place.

4 I have never criticized the Radcliffe  
5 Committee for its emphasis on liquidity, but I have  
6 criticized it for thinking that that emphasis on  
7 liquidity in some way negated the potency of  
8 ordinary central banking. What it does negate is  
9 simply quantity theory reasoning and rules for the  
10 central bank. The interest rate effects I have  
11 been speaking about are very closely related to  
12 liquidity effects.

13 Now, I should perhaps point out that when  
14 you get manufacturing corporations depending very  
15 much upon internal finance and being very liquid in  
16 that sense, you will have a time when the same  
17 patterns of central banking activity will have less  
18 effect upon their investment spending because such  
19 corporations work through their own banker under those  
20 circumstances, and liquidity enters in that particular  
21 way.

22 If I deal with the fundamentals, I would  
23 also have to point out that the way we financed  
24 World War II drastically altered in the post-war  
25 period the total amount of cash in the community,  
26 plus the total amount of assets in the form of  
27 government bonds. Now, it wasn't a mere swap because  
28 the typical American individual, when he owns a  
29 government bond, doesn't say to himself, "True,  
30 I own this bond, and as a person and as a taxpayer



...of different kinds, if you like, the  
...position of the community, and these  
...have changed from place to place.

I have not mentioned the possibility  
...of ... but I have  
...that ...

...in need of ... of  
...What it does not do is  
...and ...

...I have  
...which ...

Now, I should ...  
...very  
...in

...time when the  
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...these  
...in this position

...I want  
...that the way we ...

...in the post-war  
...community,  
...in the form of  
...it wasn't a more ...

...when he was a  
...as a taxpayer





1 I will have to pay the interest on it and hold it  
2 for a certain date and therefore when I draw my  
3 balance sheet of net worth I will cancel out my  
4 ownership on the government instrument by my  
5 obligation as a citizen". If he did this, then  
6 there would be no massive increase in liquidity, but  
7 there was a massive increase in liquidity and it was  
8 related to the wartime central bank and treasury  
9 activities. I don't therefore, want to go on record  
10 as putting emphasis upon the existing rate structure  
11 in a way that denies that liquidity has an effect.

12 There are also some independent liquidity  
13 factors, and I will make one last remark in this  
14 connection. In the years after the war in connection  
15 with the New York Federal Reserve Bank, and  
16 particularly associated with the names of Alan  
17 Sproul, Professor J. H. Williams of Harvard  
18 University and the New York Federal Reserve Bank,  
19 and Dr. Robert V. Roosa, then director of research  
20 and vice-president for the New York Federal Reserve,  
21 and now under-secretary of the Treasury, there  
22 grew up a notion -- almost a mystique I would say,--  
23 that the central bank can accomplish much by  
24 creating uncertainty. In addition to the pattern of  
25 interest rates which you read about in the New York  
26 Times in the morning, there exists varying degrees  
27 of uncertainty. What you don't see is that Alan  
28 Sproul, like a Toreador, is waving a red flag so  
29 that the bull can't understand which way he will go.  
30 So superimposed upon that same structure of interest



I will have to pay the interest on it and hold it  
for a certain date and therefore when I draw my  
balance sheet or pay notes I will cancel out my  
membership on the Government's statement by my  
obligation as a citizen. If on this, then  
there would be no massive increase in liquidity, but  
there was a massive increase in liquidity and it was  
related to the entire central bank and treasury  
activities. I don't remember, what so far as recent  
as putting emphasis upon the existing state of affairs  
in a way that means that liquidity was an effect.  
There are also some independent liquidity  
factors, and I will mention just some in this  
connection. In the year after the war in connection  
with the New York Federal Reserve Bank, and  
particularly associated with the names of Alan  
Greenspan, Frederick S. H. Williams of Harvard  
University, and the New York Federal Reserve Bank,  
and Dr. Arthur H. Burns, then director of research  
and vice-president of the New York Federal Reserve,  
and now under-secretary of the Treasury, there  
was a notion - almost a conviction I would say -  
that the central bank can accomplish much by  
manipulating the money. In addition to the pattern of  
interest rates which you read about in the New York  
Times in the morning, there exists varying degrees  
of uncertainty. What you don't see is that Alan  
Greenspan, like a nobody, is waving a red flag so  
that the bull can't understand which way he will go.  
So superimposed upon that same structure of interest



1 rates is a degree of uncertainty which makes people  
2 feel less liquid and therefore has a restraining  
3 effect. In that sense of liquidity, of uncertainty  
4 about changes, there are some effects. I think  
5 the New York Federal Reserve school exaggerated them,  
6 but perhaps it was in a good cause at that time.

7 COMMISSIONER LEMAN: May I ask a question  
8 at this point? After the war the holding of govern-  
9 ment bonds by the public or by a citizen who would  
10 draw up his balance sheet, I thought you said that  
11 there could not have been a purely rational analysis  
12 of this situation in increased liquidity because he  
13 should have realized that he would have to pay for  
14 the services and the fact is that on any such balance  
15 sheet which he would make he considers the obligation  
16 to pay for that as a long-term sort of obligation,  
17 whereas he still considers the bond as an asset?

18 PROFESSOR SAMUELSON: I want to be  
19 absolutely non-committal in terms of whether it is  
20 rational or irrational for him to do what he does,  
21 but I do mean to assert that he doesn't treat as  
22 a liability the full equivalence of that asset. If  
23 you want me to comment on whether I think it is  
24 rational ----

25 COMMISSIONER LEMAN: He is bound not to  
26 treat it as a current liability?

27 PROFESSOR SAMUELSON: Yes.

28 COMMISSIONER LEMAN: But he may treat it  
29 as a liability, if he wants it to be a liability,  
30 but not a current one; he will treat the bond as a



vinilgrecu 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 104, 105, 106, 107, 108, 109, 110, 111, 112, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 124, 125, 126, 127, 128, 129, 130, 131, 132, 133, 134, 135, 136, 137, 138, 139, 140, 141, 142, 143, 144, 145, 146, 147, 148, 149, 150, 151, 152, 153, 154, 155, 156, 157, 158, 159, 160, 161, 162, 163, 164, 165, 166, 167, 168, 169, 170, 171, 172, 173, 174, 175, 176, 177, 178, 179, 180, 181, 182, 183, 184, 185, 186, 187, 188, 189, 190, 191, 192, 193, 194, 195, 196, 197, 198, 199, 200, 201, 202, 203, 204, 205, 206, 207, 208, 209, 210, 211, 212, 213, 214, 215, 216, 217, 218, 219, 220, 221, 222, 223, 224, 225, 226, 227, 228, 229, 230, 231, 232, 233, 234, 235, 236, 237, 238, 239, 240, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 277, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 332, 333, 334, 335, 336, 337, 338, 339, 340, 341, 342, 343, 344, 345, 346, 347, 348, 349, 350, 351, 352, 353, 354, 355, 356, 357, 358, 359, 360, 361, 362, 363, 364, 365, 366, 367, 368, 369, 370, 371, 372, 373, 374, 375, 376, 377, 378, 379, 380, 381, 382, 383, 384, 385, 386, 387, 388, 389, 390, 391, 392, 393, 394, 395, 396, 397, 398, 399, 400, 401, 402, 403, 404, 405, 406, 407, 408, 409, 410, 411, 412, 413, 414, 415, 416, 417, 418, 419, 420, 421, 422, 423, 424, 425, 426, 427, 428, 429, 430, 431, 432, 433, 434, 435, 436, 437, 438, 439, 440, 441, 442, 443, 444, 445, 446, 447, 448, 449, 450, 451, 452, 453, 454, 455, 456, 457, 458, 459, 460, 461, 462, 463, 464, 465, 466, 467, 468, 469, 470, 471, 472, 473, 474, 475, 476, 477, 478, 479, 480, 481, 482, 483, 484, 485, 486, 487, 488, 489, 490, 491, 492, 493, 494, 495, 496, 497, 498, 499, 500, 501, 502, 503, 504, 505, 506, 507, 508, 509, 510, 511, 512, 513, 514, 515, 516, 517, 518, 519, 520, 521, 522, 523, 524, 525, 526, 527, 528, 529, 530, 531, 532, 533, 534, 535, 536, 537, 538, 539, 540, 541, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 554, 555, 556, 557, 558, 559, 560, 561, 562, 563, 564, 565, 566, 567, 568, 569, 570, 571, 572, 573, 574, 575, 576, 577, 578, 579, 580, 581, 582, 583, 584, 585, 586, 587, 588, 589, 590, 591, 592, 593, 594, 595, 596, 597, 598, 599, 600, 601, 602, 603, 604, 605, 606, 607, 608, 609, 610, 611, 612, 613, 614, 615, 616, 617, 618, 619, 620, 621, 622, 623, 624, 625, 626, 627, 628, 629, 630, 631, 632, 633, 634, 635, 636, 637, 638, 639, 640, 641, 642, 643, 644, 645, 646, 647, 648, 649, 650, 651, 652, 653, 654, 655, 656, 657, 658, 659, 660, 661, 662, 663, 664, 665, 666, 667, 668, 669, 670, 671, 672, 673, 674, 675, 676, 677, 678, 679, 680, 681, 682, 683, 684, 685, 686, 687, 688, 689, 690, 691, 692, 693, 694, 695, 696, 697, 698, 699, 700, 701, 702, 703, 704, 705, 706, 707, 708, 709, 710, 711, 712, 713, 714, 715, 716, 717, 718, 719, 720, 721, 722, 723, 724, 725, 726, 727, 728, 729, 730, 731, 732, 733, 734, 735, 736, 737, 738, 739, 740, 741, 742, 743, 744, 745, 746, 747, 748, 749, 750, 751, 752, 753, 754, 755, 756, 757, 758, 759, 760, 761, 762, 763, 764, 765, 766, 767, 768, 769, 770, 771, 772, 773, 774, 775, 776, 777, 778, 779, 780, 781, 782, 783, 784, 785, 786, 787, 788, 789, 790, 791, 792, 793, 794, 795, 796, 797, 798, 799, 800, 801, 802, 803, 804, 805, 806, 807, 808, 809, 810, 811, 812, 813, 814, 815, 816, 817, 818, 819, 820, 821, 822, 823, 824, 825, 826, 827, 828, 829, 830, 831, 832, 833, 834, 835, 836, 837, 838, 839, 840, 841, 842, 843, 844, 845

the New York Central Railroad and I exaggerated them.

9-11-61

SECRET

11. THE FIRST OF THE "WALL" PROVISIONS





1 current asset?

2 PROFESSOR SAMUELSON: I think I will put  
3 into the record now that you said it was rational for  
4 him to act in that way; I don't pass judgment on  
5 that.

6 THE CHAIRMAN: Yes, but the liability would  
7 be his and it would have to appear in his balance  
8 sheet whether he owned the bond or not.

9 PROFESSOR SAMUELSON: Yes. What I meant  
10 was the following. For a consolidated balance sheet  
11 of all the citizens in the community, if it were true  
12 that those who owned bonds were matched by a recognition  
13 on their part of their share of the liability, and for  
14 those who didn't own a bond, the recognition of their  
15 part of the liability, so that when we consolidated,  
16 the total of the liability equalled the total of the  
17 asset, and this conditioned each person's behavior;  
18 then, I don't think that the system could be regarded  
19 as being terribly more liquid than before. Whether  
20 it is rational or not, I don't believe that the  
21 community acts in that way. It acts as if it is  
22 richer than certain methods of accounting would  
23 suggest it really is, and that is why I say, --  
24 without any moral judgment or any statement of  
25 whether it is rational or irrational -- that the  
26 American people came out of the war in an extremely  
27 liquid position. If you press me, I will comment  
28 on the rationality or irrationality of it, but  
29 if you don't press me, I will not!

30 COMMISSIONER LEMAN: I wish you would.





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PROFESSOR SAMUELSON: I think as far as the individual is concerned, in the stream of history and knowing the way the nation keeps its books with respect to generations, and so forth, that a case can be made out that it is not irrational for me to disregard this obligation. I only keep in mind what my tax rate will be in the next ten years, and what my income will be in making my decision. I don't go around with the load of the public debt on my shoulders, or when I look at my children I don't see a phantom public debt on their shoulders, and when I look at my phantom grandchildren -- who have not yet appeared -- I don't see them with a load of debt on them.

And the same problem could come about with respect to the issue of currency. If you don't think the society is a going concern, you should look at all the currency in the community, which is the non-interest bearing I.O.U.'s of the government. The answer to the question what is it payable in terms of is simply: it is payable only in terms of another I.O.U. The public debt is a sort of fiduciary issue.

All we think about in our lifetime is that you cannot take it with you, but before you go you can do something with it, and we take that to be a fact.

If you thought of society as having a declining population and liquidating, or if you want an exercise with respect to doomsday -- say that it is vouchsafed to you that an atomic bomb will fall







1 nineteen days from now at one o'clock -- some quite  
2 violent things would happen no doubt to the velocity  
3 of circulation of money under these circumstances,  
4 particularly if there was a division of opinion.

5 COMMISSIONER BROWN: If you once started  
6 on this you would have to take into consideration  
7 their share of the assets, too?

8 PROFESSOR SAMUELSON: Yes, but most of the  
9 World War II debt was incurred for the worthy asset  
10 of preserving our way of life.

11 COMMISSIONER BROWN: There are a few  
12 capital assets?

13 PROFESSOR SAMUELSON: Yes, government  
14 has quite a lot of assets.

15 COMMISSIONER BROWN: And some of these  
16 assets are liabilities in the sense of maintenance  
17 and so forth?

18 PROFESSOR SAMUELSON: Yes, it is like some  
19 of the savings my wife makes; we can scarcely afford  
20 them!

21 COMMISSIONER GIBSON: Isn't it true that  
22 when a business community issues a lot more short-  
23 term paper that this makes the whole community feel  
24 more liquid? There are two sides to that too. This  
25 short-term business paper and liquidity assets for  
26 a lot of people has an advantage but this can be  
27 restricted by the issue of paper which will off-  
28 set ---

29 PROFESSOR SAMUELSON: There is the old  
30 joke about the island with no resources where everybody





between 1935 from now at one o'clock -- some quite  
of circulation of money under these circumstances,  
particularly if there was a division of opinion.

COMMISSIONER BROWN: It was once reported  
on this you would have to take into consideration  
that there is no money, now?

PROFESSOR SAMUELSON: Yes, but most of the  
money was in debt was borrowed -- how would you  
of providing any way of life.

COMMISSIONER BROWN: There was a

PROFESSOR SAMUELSON: Yes, I think

has quite a lot of money.

COMMISSIONER BROWN: And now it is

there is no circulation in the sense of an insurance  
and no money.

PROFESSOR SAMUELSON: Yes, it is like some  
of the situation of the money; we can actually afford

COMMISSIONER BROWN: Isn't it true that

when a business community takes a lot more money

there is no money and the money is not  
there is no money? There are two sides to that too. This

short-term business paper and liquidity assets for

a lot of people and an advantage but this can be

replaced by the issue of paper which will not

not --

PROFESSOR SAMUELSON: There is the old

and now at the island with no resources where everybody



1 lives by taking in each other's washing. I think  
2 liquidity is like that; we all live by the promises  
3 we make to each other and there is a kind of a social  
4 contract and social consensus, which is why I accept  
5 a Canadian dollar bill when you give me one. But  
6 suppose that at any instant in time everybody began  
7 to have doubts about it being a going concern, then you  
8 get an internal-drain crisis -- which we have had in  
9 history -- where you get a run on the banking system.  
10 It is interesting to me that in a simple statement to  
11 you I was mentioning what is, after all, probably  
12 the most important function of a central bank, but  
13 which is so taken for granted that we never even  
14 mention it any more -- that at a time of internal  
15 crisis, when people have doubts about the liquidity  
16 and soundness of a fractional banking system, the  
17 central bank is there if necessary as a legitimate  
18 counterfeiter to satisfy that demand. I emphasize  
19 this because there is no fractional reserve banking  
20 system that can liquidate itself if everybody wants  
21 his money simultaneously. That is, it cannot do it  
22 without the aid of the central bank. Since the time  
23 of Bagehot it has been recognized by experts and  
24 ever since 1935 it has been recognized by legislation  
25 that the function of the central bank is, in such a  
26 situation, to create the liquidity that the public  
27 wants. Of course, once the public knows it can get it,  
28 it typically doesn't want it.

29 COMMISSIONER GIBSON: You are emphasizing  
30 that liquidity is a state of mind rather than a







1 measurable clear-cut phenomenon?

2 PROFESSOR SAMUELSON: Yes indeed, because  
3 when we analyse liquidity technically we find it  
4 refers to two or three features and one, from the  
5 individual standpoint, is: is this thing transferable.

6 Now, there were some horrible mistakes made  
7 by the founders of the Federal System in 1913 in this  
8 respect; they thought that the most liquid asset  
9 imaginable was a 90-day or a 180- day promissory note  
10 from a local hardware merchant or a local farmer with  
11 the bank, whereas they thought that an 80-year  
12 government bond -- that is, a bond with a maturity  
13 of 80 years -- was one of the most illiquid things  
14 possible. Now, from the standpoint of transferability  
15 this is not true: You can sell government bonds on  
16 Sunday; that is, one bank can sell government bonds  
17 on Sunday. But one bank alone knows the credit-  
18 worthiness of its neighbour and his I.O.U. is not  
19 liquid in that sense. The founders had a grain of  
20 truth on their side: namely, that in ordinary  
21 eventualities, the cycle of repayment meant that  
22 the hardware dealer was supposed to get out of debt  
23 at the end of that period. (But any person who has  
24 lived in a small town knows what the actual facts  
25 are, that there was a renewal of these notes in  
26 many cases.)

27 Transferability from the individual view-  
28 point is an important aspect of liquidity and, of  
29 course, it is not the same for the group as it is for  
30 each individual. Transferability at a predictable





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PROFESSOR SAMUELSON: Yes indeed, because

when we analyze judicially technology we find it

refers to two or three features and one, from the

individual standpoint, it is not being transferred.

Now, there were some horrible mistakes made

by the founders of the Federal System in 1917 in this

respect; they thought that the new judicial system

was a 50-year or a 60-year project and that

it was a long, slow process and that it would take

the best, wisest men that they had at the time

to do it -- that is, a long time and a lot of

of the time -- and we are now in a position to

realize. Now, from the standpoint of the new judicial

system, it was not until 1960 that the new judicial

system was established, and it was not until 1960

in Canada, and we have since known the new

workings of the judicial system and the L.O.E. is not

judicial in that sense. The members of the group

stand on their own; none of them is a judge.

eventually, the chief of the judicial system is

the baroque leader who is supposed to be out of touch

at the end of the process. But the group who are

close in a small group with the judicial system

are, that there was a network of these people in

many cases.)

Transferring it from the individual view-

point to an important aspect of judicial technology.

Of course, it is not the same for the group as it is for

each individual. Transferring it as a predicate



Nethercut & Young

Toronto, Ontario

- 6273 -

1 price is another aspect of liquidity and here the  
2 80-year bond is not as liquid as the 90-day bill.  
3 All these things are states of mind.

4 At a time during the 1930's when people  
5 were pre-occupied with the high money rates that  
6 prevailed in the 1920's, they felt that a return to  
7 long-term government bonds -- be it 30 years duration  
8 -- didn't seem like a terribly liquid thing to  
9 individuals and therefore there was this liquidity  
10 preference. I believe that the technical explanation  
11 is not a hard concept; it is a fluctuating thing  
12 and fluctuates with circumstances and also fluctuates  
13 with the induced activities and utterances of the  
14 central bank and it does have subsequent effects  
15 on certain kinds of spending.

16 COMMISSIONER GIBSON: Do you think it is  
17 possible to analyse in a useful sort of way the  
18 current attitude toward liquidity. We have had  
19 certain people before our Commission, business people,  
20 and we have asked them how they feel about this, and  
21 how their decisions are changed by a change in the  
22 degree of liquidity in their concerns and so on, and  
23 we got rather varied answers. There was not anything  
24 very clear about it. The only thing I got out of it  
25 was the idea that maybe they would move in the same  
26 sort of direction, although their habits were  
27 different under some circumstances. Is there anything  
28 you want to say about this? This is an area that  
29 does not seem to have been explored very well.

30 PROFESSOR SAMUELSON: I think that the



...is another aspect of rigidity and here the  
...year bond is not as rigid as the 90-day bill.  
All these things are aspects of rigidity.

At a time when the world's money

were concentrated in the hands of a few nations

concentrated in the hands of a few nations

international government, there -- as in 19 years before

-- there was a great deal of rigidity

individuals and nations were not so rigid

monopoly. I believe that the rigidity of the

to have a hard currency; it is a rigidity of the

and it is mixed with other things and also the rigidity

with the rigidity of the world and rigidity of the

rigidity of the world and it is not a rigidity of the

on the rigidity of the world.

...the rigidity of the world.

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...the rigidity of the world.

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...the rigidity of the world.

PROFESSOR SAMUELSON: I think that the





1 actual observed actions of business will not prove to  
2 be quite the same as their verbal utterances in respect  
3 to those actions partly because there is a certain  
4 amount of rationalization involved, partly because  
5 the form of the question is different and partly  
6 because of the fact that you don't have to be able  
7 to articulate what it is you are doing. I think the  
8 suggestions and the reasoning confirms the  
9 proposition that the more liquidity their business  
10 has the more willing it is at the margin to tie  
11 itself up in capital formation which uses up liquidity.  
12 If you have more of something to devote to a purpose  
13 you won't devote all of it there, because you want  
14 liquidity. But you will have a little more surplus  
15 liquidity and, therefore, you will invest more.

16 We have had some excellent statistical  
17 studies that throw some light on this. I would refer  
18 to Professors John Meyer and Edwin Kuh, who have a  
19 book on the subject, and it is their conclusion  
20 that a good deal of the investment behaviour of  
21 American manufacturing enterprises in a number of  
22 post-war years could be explained and related to the  
23 cash flow that comes to them through earnings plus  
24 depreciation and accruals. I think that recommends  
25 itself to our reason, as we think what we would do  
26 if we were businessmen and found some of the facts,  
27 but the relationship is not rigid. There is a time  
28 like now when there is a considerable amount of  
29 evidence that American corporations this year are  
30 in a rather liquid position from their cash flow





1853 -



1 viewpoints, and have not used up that liquidity by  
2 elaborate plant and equipment investment commitments.  
3 This suggests to me that at this time if the Federal  
4 Reserve eased there would not be as big a reaction  
5 to that degree of an easing as there would be at  
6 some earlier time when business liquidity seemed  
7 lean.

8 COMMISSIONER GIBSON: Thank you. I would  
9 like to now ask a few questions about velocity  
10 and near money, and things in this general area.  
11 You suggest in your memorandum that some changes  
12 in velocity are reasonably predictable, or may be  
13 reasonably predictable. You do not elaborate on  
14 this. Would you give me a better idea of what you  
15 have in mind there?

16 PROFESSOR SAMUELSON: Well, there are  
17 certain long-term trends in velocity which may be  
18 predictable. There are certain changes during the  
19 cycle. I should be surprised, for example, if  
20 in future business cycles in the United States, as  
21 traced out, say in the records of the National  
22 Bureau of Economic Research, you do not see that  
23 simple trend in the velocity of circulation of  
24 money with the cycle itself.

25 Now, the crucial question to which I was  
26 addressing myself was this. When the central bank  
27 makes a deliberate change, what can be said about  
28 the induced changes in velocity? It depends upon  
29 the circumstances, and under certain circumstances  
30 I think you can make a prediction. In almost all







1 circumstances except the deep depression liquidity  
2 trap that I mentioned, I think you can make the  
3 prediction that a change in velocity, whether it be  
4 upward or downward, but particularly if it were to  
5 be downward, will not in all probability be downward  
6 enough to wipe out the original expansion of M. The  
7 only exception I can think of would be if the central  
8 bank did something very unconventional and the effect  
9 of that were to paralyze confidence and set off, there-  
10 fore, certain forces which would affect the velocity.  
11 I think that is an extremely rare situation.

12 Now, when I said the effect was predictable,  
13 I do not mean to say that if the central bank expands  
14 M today, and you look at the records tomorrow, you  
15 will find that the velocity did not follow. What  
16 I mean is, the effect which can be attributed to an  
17 increase in M itself. Most instances when the central  
18 bank is increasing the amount of money, if it is a  
19 good central bank, are in a time of decline -- in  
20 recession. Therefore, the velocity is probably  
21 declining and the central bank is doing its little  
22 bit to offset that. But, if somehow you could make  
23 a controlled experiment to see what the change in  
24 velocity was compared with what it otherwise would  
25 have been, then I think you would find that in many  
26 stages of the cycle the velocity would predictably  
27 decline very little even though the amount of money  
28 were increased. There are other circumstances where  
29 I think the velocity would almost completely offset  
30 your behaviour. I should say that this is my opinion.





January 1914  
New York

REVEREND FATHER, I have the honor to acknowledge the receipt of your letter of the 10th inst.

in reply to the one I mentioned, I think you can make the

prediction that a change in velocity, whether it be

upward or downward, but particularly so in cases of

be downward, will not in all probability be sufficient

enough to wipe out the original momentum of the

only exception I can think of would be if the velocity

were of a magnitude very much greater than the original

of that kind of motion, and in such cases the velocity

would, certainly, be much greater than the original

I think that is an extremely good illustration.

Now, when I said the effect was greater than

I do not mean to say that in the case of a body moving

in a straight line, and then being deflected, the velocity

will then be the same as the original velocity.

I mean, the effect will be the same as if the

impulse is M times. Most instances when the velocity

is increased the amount of energy is increased.

and in the case of a body moving in a straight line

and then being deflected, the velocity is increased.

declining and the centrifugal force is also

fit to other cases. But, if somehow you could make

a hypothetical experiment to see what the change in

velocity was compared with what it otherwise would

have been, then I think you would find that in most

cases of the whole the velocity would be increased

decline very little even though the amount of energy

was increased. There are many cases of this kind.

I think the velocity would almost completely offset

your objection. I should say that this is my opinion.



1 At least one very respected and excellent economist,  
2 Professor Milton Friedman of the University of  
3 Chicago is of a different opinion. He is of that  
4 different opinion based upon his extensive historical  
5 researches on the subject covering practically a  
6 ten-year period. However, I still hold my opinion  
7 after having looked at some of his data.

8 COMMISSIONER GIBSON: One of the most  
9 interesting aspects of this, and one of the most  
10 frequent discussions before this Commission is in  
11 respect of the question of how far the increase in  
12 velocity will go, and that depends on your concept  
13 of velocity; and also the increase in the use of  
14 near money in a boom period where monetary policy  
15 is trying to seal things up; how far this increase  
16 in velocity and near money offsets the policies that  
17 the central bank is trying to pursue, and this brings  
18 the whole question of near banks and their activities  
19 into the picture.

20 PROFESSOR SAMUELSON: Yes.

21 COMMISSIONER GIBSON: I am very interested  
22 in that. Would you care to comment in this regard?

23 PROFESSOR SAMUELSON: I think it is natural  
24 and to be expected that when businessmen's velocity  
25 increases and when the central bank tries to put  
26 a restraining hand on that process the velocity will  
27 to a considerable degree increase so as to offset  
28 that restraining hand. What I think is wrong is to  
29 think that velocity will increase enough to offset  
30 it completely.



Professor Milton Friedman of the University of Chicago is of a different opinion. He is of that different opinion based upon his extensive historical researches on the subject covering practically a ten-year period. However, I still hold my opinion after having looked at some of his data.

There are two of the most interesting aspects of this, and one of the most important elements in the Commission is in respect of the question of how far the increase in velocity will go, and what depends on your concept of velocity; and also the interest in the use of hard money in a long period where we really follow in trying to deal through not how far this increase in velocity and what money. That's the problem that the central bank is trying to pursue, and this brings the whole question of hard money and their activities into the picture.

COMMISSIONER SIMMONS: I am very interested in that. Would you care to comment in this regard?

PROFESSOR FRIEDMAN: I think it is natural and to be expected that when businessmen's velocity increases and when the central bank tries to put a restraining hand on that process the velocity will be a considerable degree increase so as to offset that restraining hand. What I think is wrong is to think that velocity will increase enough to offset it completely.





1                    COMMISSIONER GIBSON: There will be a net  
2 gain as a result?

3                    PROFESSOR SAMUELSON: There will be a net  
4 gain as a result and there is also a signal to the  
5 central bank for more of the same.

6                    The important policy of a central bank is  
7 that it should feel its way. I think that Alan  
8 Sproul said "to probe the market"; you push more and  
9 more and if you haven't done enough you push further  
10 in that direction. You may overdo it because there  
11 are lags involved, but it is not necessary, to be  
12 an effective central bank, to do that through fiscal  
13 policy. It is not necessary for us to recognize, as  
14 professors of economy, any data; all that is needed  
15 is a strong proposition that if you move in this  
16 direction the effects upon the system will be  
17 predictable in this direction. Now, if in fact when  
18 you tighten money, velocity was guaranteed to increase  
19 enough to wipe out this money and 50 per cent again,  
20 you could live with that system. It would just be  
21 a central bank always operating in reverse.

22                    During the war I remember there was a very  
23 famous Draper gunsight that had the great virtue  
24 that if it did not work you threw it overboard.  
25 There was one little problem with it. If you hunt  
26 ducks you ordinarily aim ahead of the duck, and if  
27 you are hunting, if you will excuse the expression,  
28 aeroplanes you would ordinarily aim ahead. With  
29 the Draper sight, if you found your tracer bullets  
30 were ahead of the thing instead of moving this way





COMMISSIONER GLEASON: There will be a net

gain as a result?

PROFESSOR SAMUELSON: There will be a net

gain as a result and there is also a signal to the

general bank for more of the same.

The important matter of a central bank is

what it should feel the way. I think that Alan

Spence said "to prove the market"; you know that and

more and if you haven't done enough you must wait

in that direction. You may wonder it because there

are laws involved, but it is not necessary, so far

an effective central bank, to do that kind of thing.

policy. It is not as easy for us to regulate, as

collections of money, any other; all that is needed

is a strong proposition that if you move in this

direction the effect upon the system will be

predictable in this direction. Now, if in fact you

you tighten money, velocity will tend to increase

enough to wipe out this money and let you come back.

you could live with that system. It would be a

a central bank always operating in reverse.

During the war I remember there was a very

James Dwyer statement that had the great virtue

that it did not work you knew it was wrong.

There was one little problem with it. If you had

ducks you ordinarily aim ahead of the duck, and if

you are hunting, if you will excuse the expression,

reophanes you would ordinarily aim ahead. With

the Dwyer right, if you found your tracer bullets

were ahead of the thing instead of moving this way



1 you moved the other way. It was amazing how 18-year  
2 old navy men would learn in about half an hour to  
3 adjust in that way, just the way a dentist sees  
4 everything in a mirror.

5 COMMISSIONER GIBSON: You are not suggesting  
6 this is so?

7 PROFESSOR SAMUELSON: No, and none of the  
8 witnesses before the Radcliffe Committee said that  
9 this was so, or even that the velocity would just  
10 wipe out the effects. However, in that deep  
11 depression liquidity trap situation that doctrine  
12 would almost literally be correct, that velocity  
13 changes would just exactly wipe out the increase in M.

14 COMMISSIONER GIBSON: But in a boom  
15 era, supposing the velocity change wiped out say  
16 two-thirds of the change in quantity -- well, it is  
17 not as simple as that. What the central bank does  
18 is not allow the money supply to increase and cause  
19 a demand rising and the velocity goes up?

20 PROFESSOR SAMUELSON: Yes.

21 COMMISSIONER GIBSON: Supposing the  
22 velocity factor in the creation of credit outside  
23 the banking system works to offset this policy to  
24 a major degree, have you any thoughts about policies  
25 in this area, where a deliberate measure leads to  
26 inflationary activities of certain other financial  
27 intermediaries and certain other kinds of  
28 transactions?

29 PROFESSOR SAMUELSON: I have no definite  
30 recommendations, to make, but my general economic



THE BUREAU OF LAND MANAGEMENT, DEPARTMENT OF THE INTERIOR, WASHINGTON, D. C. 20250

RECEIVED IN THAT WAY, THAT THE WAY A FEW OF THEM

EVERYTHING IN A MINUTE.

COMMISSIONER OF BUREAU: You are not satisfied.

What is it?

PROFESSOR SAMUELSON: I am not sure of it.

What is the reason for this? I am not sure of it.

It is not clear to me, the reason for this.

What is the reason for this? I am not sure of it.

Professor, I am not sure of it, the reason for this.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

COMMISSIONER OF BUREAU: I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

PROFESSOR SAMUELSON: I am not sure of it.

COMMISSIONER OF BUREAU: I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

What is the reason for this? I am not sure of it.

PROFESSOR SAMUELSON: I am not sure of it.

What is the reason for this? I am not sure of it.





1 diagnosis would be that you do not want to have what  
2 we have in the United States: non-member banks who  
3 are free from the reserve regulations of member banks  
4 and who, therefore, come into their own as sort of  
5 ersatz banks when the Federal Reserve is putting  
6 pressure on the member banks. In principle you ought  
7 to impose the same regulations on all banks. I do not  
8 think it quite follows from this that other insurance  
9 companies should be subjected to the same degree of  
10 scrutiny, that is proper for commercial banks. I am  
11 sure that in our country the mutual savings banks  
12 and public lending associations provide many, many  
13 of the functions of money, and it would be I think  
14 in the public interest not to require the central  
15 bank to operate terribly hard on that narrow area  
16 where it can impinge directly to achieve the same  
17 effects, because it is a distortion to do it that  
18 way. It is better probably to be able to put on  
19 pressure a little more widely.

20 COMMISSIONER GIBSON: You think it is a  
21 big enough distortion to take seriously, in other  
22 words? We have had suggestions by some witnesses  
23 from your country that it is a distortion but not  
24 terribly important and, therefore, for the time  
25 being probably nothing should be done about it.

26 PROFESSOR SAMUELSON: I do not think that  
27 I am in a position to make a concrete recommendation  
28 in respect of the position of the central banks and  
29 just what the control ought to be over finance  
30 intermediaries. I do think in time, for example,





...would be that you do not want to have any  
...in the United States: non-member bodies  
...from the massive registration of western  
...and who, therefore, come from their own as part of  
...when the Federal Reserve is doing  
...on the market. In principle, you have  
...the same registration on all levels. I am not  
...of course, but this is what I mean  
...to be joined to the same level as  
...I am  
...and public funding  
...of the Federal Reserve, and it will be I think  
...in the public interest and to help the economy  
...to be joined to the same level as  
...to be joined to the same level as  
...to be joined to the same level as  
...to be joined to the same level as  
...to be joined to the same level as  
...to be joined to the same level as  
...to be joined to the same level as

...I am in a position to make a concrete recommendation  
...in respect of the position of the central bank  
...that what the central bank should be over-riding  
...I am in a position to make a concrete recommendation  
...in respect of the position of the central bank  
...that what the central bank should be over-riding



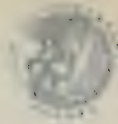
1 that if your country here ever resorts to directives,  
2 in which directive the commercial banks are told to  
3 do such and such with respect to your lending policies,  
4 that at such a time a directive ought to be given to  
5 insurance companies. It needn't be the same  
6 directive, but I do not see why one should be let  
7 off Scott free while the other has a great deal of  
8 tightness on it. I believe that by enough tightness  
9 on commercial banks you can put a great deal of  
10 tightness in the system. It is a little bit like  
11 a tourniquet around the neck; in order to get that  
12 over-all tightness it is a little hard on the neck,  
13 or the commercial bank.

14 COMMISSIONER GIBSON: In other words you  
15 think in terms of what is sometimes described as  
16 moral suasion in this outer area?

17 PROFESSOR SAMUELSON: Excuse me. When I  
18 said a "directive" I didn't mean what we laughingly  
19 call "moral suasion" which involves not even a  
20 slap on the wrist. I was thinking of the kind of  
21 directive that the Chancellor gives in the United  
22 Kingdom which has force in it. Dr. Holtrop I  
23 believe testified before you about the directives  
24 that the Dutch government gives to the central  
25 bank.

26 COMMISSIONER GIBSON: Yes, but he said  
27 the central bank had powers to do things in this  
28 area by legislation and they did not usually do  
29 it, they made suggestions instead.

30 PROFESSOR SAMUELSON: Yes.



...in your opinion that you would be ...  
...the ...

...and such with respect to your ...  
...that at such a time a directive ought to be given to

...insurance companies. It might be the same  
...directive, but I do not say they are ...

...and that while the other was a ...  
...I believe that it is ...

...on commercial banks and not a ...  
...in the ...

...a ...  
...it is a ...

...or the commercial bank.  
...COMM. SENATOR GILBERT: Is there ...

...think in terms of what is ...  
...some ...

...PROFESSOR SAMUELSON: Excuse me. When I  
...said a "directive" I didn't mean what he ...

...call "internal ...  
...I was thinking of the kind of

...directive that the Chancellor gives in the ...  
...which has come in it. Dr. Helldorf

...believe testified before you about the ...  
...that the Dutch Government gives to the ...

...COMMISSIONER GILBERT: Yes, but he said  
...the central bank had powers to do things in this

...area by legislation and they did not usually do  
...they made suggestions instead.

...PROFESSOR SAMUELSON: Yes





1 COMMISSIONER GIBSON: As I understand it  
2 in the States the powers to do these things for the  
3 most part are not in legislation?

4 PROFESSOR SAMUELSON: I think that is  
5 true. . . and in the case of . . .

6 COMMISSIONER GIBSON: Is that not right?

7 PROFESSOR SAMUELSON: That is right.  
8 We do not have four big banks or six big banks which  
9 are chained across the country, we have fifteen  
10 thousand banks. While J. P. Morgan in his heyday  
11 could crawl into his panelled library, the  
12 principal bankers in New York could do things which  
13 were regarded as in the public interest in a crisis,  
14 but it does not help for the Chairman of the Federal  
15 Reserve Board of Governors to say that the banks in  
16 Berlin, Wisconsin, or in Columbia, Missouri, ought  
17 to be tightened up. Mr. Sproul's testimony was that  
18 in his experience this is generally rather ineffective.  
19 I think therefore it is a little bit unfair or  
20 immoral to attempt it because it makes those who  
21 are extremely co-operative and law-abiding -- I  
22 should not say "law-abiding", but public-spirited --  
23 take it on the chin as against the others, and you  
24 should not do that because in an emergency, and  
25 particularly in a country of this type, the kind  
26 of animal with which we are concerned is a very  
27 moral animal, and moral suasion is an effective  
28 thing in respect to the bulk of cases.

29 COMMISSIONER GIBSON: Would you agree that  
30 the most important factor in producing this contrary





REPRESENTATIVE GIBSON: I think that is  
the case for many of the States.

and that one is in legislation?

REPRESENTATIVE GIBSON: I think that is

the case.

COMMISSIONER GIBSON: It does not appear

that it is the case.

We do not have any bill on the table which

is intended to amend the law.

REPRESENTATIVE GIBSON: Will you then in this matter

not give me any information?

REPRESENTATIVE GIBSON: I have heard of some which

are intended to amend the law in a certain

and it does not appear that the Government of the State

has any bill on the table.

REPRESENTATIVE GIBSON: Will you then in this matter

not give me any information?

REPRESENTATIVE GIBSON: It is generally known that

I think it is one of the bills on the table

and it is intended to amend the law.

REPRESENTATIVE GIBSON: Will you then in this matter

not give me any information?

REPRESENTATIVE GIBSON: It is generally known that

it is one of the bills on the table

and it is intended to amend the law.

REPRESENTATIVE GIBSON: Will you then in this matter

not give me any information?

REPRESENTATIVE GIBSON: It is generally known that

COMMISSIONER GIBSON: Would you agree that

the bill is one of the bills on the table



1 action in the area of velocity is the outside  
2 institutions, particularly in times of high interest  
3 rates which multiply and intensify ---

4 PROFESSOR SAMUELSON: Yes, high interest  
5 rates, and in time of stringency, the near money  
6 substitutes are meeting extremely accommodating  
7 holders. In other words, it is very near money in  
8 those circumstances.

9 To illustrate this point, you can get in  
10 the City of Boston at the moment 3 per cent on your  
11 savings account on a daily basis, per day. That  
12 means that anyone with any means will have a much  
13 smaller chequing account which he holds in between  
14 the purchases of different kinds of securities.  
15 The bank is very accommodating and will not get  
16 angry at you if you begin to use your savings account  
17 as if it were your chequing account. Whereas when  
18 money is easy, they really do not want customers.  
19 They will say to you, "Look here, if you are going  
20 to make this sort of entry every day, and every time  
21 you want to buy a dozen eggs you go and use your  
22 savings account, then we will not give you a per  
23 day treatment". This is associated with the  
24 effective rise in interest rates and with the  
25 velocity increases. It is not hard to increase  
26 velocity because very few of us are at the minimal  
27 level of cash balances where our velocity is maximum.

28 In a time of great inflation where we rush  
29 from the factory to, I will not say the saloon, but  
30 to the grocery store, to spend the money before its







1 purchasing power melts, we then get down to rock  
2 bottom velocity. But most of us can afford the  
3 luxury of a cash balance.

4 May I now bring up a matter which I meant  
5 to put in my submission, although I do not know how  
6 relevant it is to the Canadian system. We have a  
7 peculiar law in my country that a chequing account  
8 cannot pay interest. That law is a vestige from the  
9 great depression, and it is there for two reasons.  
10 One is a feeling that there is something wrong about  
11 interest on chequing accounts, and that the débâcle  
12 of the great depression and certain over-banking was  
13 related to it.

14 I think this is a matter of incorrect  
15 identification, but there is certainly a cartel  
16 reason for it. In its heyday, American business  
17 was encouraged to be very cartel-minded, and it is  
18 quite natural, under those circumstances particularly,  
19 with the branch banking system in a lot of small  
20 banks, that the bankers would like to have it  
21 legislated that they are not allowed to pay interest,  
22 or, rather, their rivals are not allowed to pay  
23 interest, on demand deposits. We are still saddled  
24 with that law. Now banks try to get round that law  
25 in various ways, such as being very accommodating  
26 in taking care of your trading stamps, and doing  
27 all sorts of things for you, but only when short-  
28 term money rates are not at the floor. If we  
29 ever get into an epoch in 15 or 20 years where  
30 short-term money rates average round 4 per cent,

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1 the demand deposits which are not allowed to bear  
2 interest will shrink in volume down to a minimal  
3 level.

4 It is for this reason that I bitterly  
5 regret that the Commission on Money and Credit in  
6 the United States made a recommendation of the  
7 contrary policy, because most of what is money in  
8 the important sense will turn out to be interest-  
9 bearing deposits. The whole purpose of reserves  
10 is not to be punitive but to have control over the  
11 money supply, and the effective money supply will be  
12 interest-bearing accounts.

13 I discovered in my travels in various  
14 countries that it is a rarity abroad for people to  
15 hold any kind of demand or chequable deposits which  
16 pay no interest. In Boston in 1922, say, you could  
17 get 6 per cent on your chequing deposits. Or, what  
18 is the same thing, during the 20's in the United  
19 States, in my experience people could cheque against  
20 their savings deposits. Now, I do not like  
21 speaking of natural tendencies, but there is a  
22 natural tendency for money to bear interest if  
23 there is a good safe interest rate, and so what many  
24 people speak of as near money will practically  
25 be the money.

26 If I were setting up a constitution for  
27 a new banking system, and if I were to watch out  
28 for all ceilings I would be against ceilings that  
29 permitted term deposits, and would prohibit them  
30 from paying more than a certain amount of interest.





The United States Department of the Treasury  
Washington, D.C. 20548

It is for this reason that I believe  
correct that the Commission on Money and Credit in  
the United States made a recommendation of the  
country before, because we are not in a position to  
the important source will turn out to be the  
best of all. The whole purpose of the  
is not to be punitive but to have control over the  
money supply, and the objective is to have control over the  
interest-bearing accounts.

However, in my view, in the  
country that is a part of the world, and  
and any kind of control or other kind of control  
pay no attention. In the case of the United States,  
not a penny on your credit account, and, when  
is the same thing, during the time of the United

States, in my experience people will never  
the United States. Now, I know that  
the kind of control, but there is a  
control, and money to be made, and  
there is a great deal of money in the world, and so what  
people speak of as money will be made.

I am writing up a constitution for  
a new banking system, and if I were to write one  
for all countries I would be against all the  
permitted bank deposits, and would provide them  
from paying more than a certain amount of interest.



1 They are all right when they are irrelevant; when  
2 they are relevant they are bad. I would be against  
3 ceilings and floors on loan rates too.

4 COMMISSIONER GIBSON: You would have no  
5 ceiling rate at all on current account deposits?  
6 In other words, banks would prefer you to pay  
7 interest as they saw fit?

8 PROFESSOR SAMUELSON: I think as compared  
9 with our present system in the United States, I  
10 would prefer that. At the very least I should like  
11 the Federal Reserve to have wider statutory limits  
12 than it now has. I think now it is three or four  
13 per cent -- it has just been changed by law a couple  
14 of days ago -- for international accounts. I  
15 should like the Federal Reserve to be able to put  
16 a ceiling of 6 per cent on banks if the money  
17 market rose to very high levels.

18 Now, whether we should get rid of all  
19 ceilings or not is perhaps a more drastic step.  
20 I think I would rather have the Federal Reserve  
21 have the right to impose ceilings as it sees fit,  
22 but in the confident expectation that the Federal  
23 Reserve would not use those conditions in a  
24 repressive way, except under very great emergency  
25 and for specific reasons; but particularly not  
26 for the reason of keeping bank earnings up.

27 COMMISSIONER LEMAN: For this reason --  
28 that is, the effect on higher interest rates of  
29 change in the character of the real money supply,  
30 and so on -- and for certain other reasons,



They are all right when they are irrelevant; when they are relevant they are bad. I would be against ceilings and floors on loan rates too.

COMMISSIONER GIBSON: You would have no

ceiling rate at all on current account deposits?

In other words, banks would prefer you to pay

interest as they saw fit?

PROFESSOR SAMUELSON: I think as compared

with our present system in the United States, I

would prefer that. At the very least I should like

the Federal Reserve to have more power.

than it now has. I think now it is three or four

per cent -- it has just been changed by law a couple

of days ago -- for international accounts. I

should like the Federal Reserve to be able to put

a ceiling of 6 per cent on banks if the money

market is very tight.

Now, whether we should get rid of all

ceilings or not is perhaps a more drastic step.

I think I would rather have the Federal Reserve

have the right to impose ceilings as it sees fit,

but in the confident expectation that the Federal

Reserve would not use those conditions in a

repressive way, except under very great emergency

and for specific reasons; but particularly not

for the reason of keeping bank earnings up.

COMMISSIONER GIBSON: That is all.

that is, the effect on higher interest rates of

change in the character of the real money supply.

that is, the effect on higher interest rates of





1 Dr. Bernstein expressed the hope, and to some degree  
2 the opinion, before us that perhaps you could work  
3 within narrow ranges of interest rates, and that  
4 interest rates would not have to go quite so high  
5 or quite so low in the future. In other words, if  
6 you worked between 3 per cent and 5 per cent instead  
7 of 2 per cent and 6 per cent, or 2 per cent and  
8 7 per cent, it would be a much happier and more  
9 effective monetary system. Do you think that that  
10 is a practicable idea? It appeals as desirable  
11 if one could do it.

12 PROFESSOR SAMUELSON: I am not sure  
13 that I understand his position. Is it his opinion  
14 that if you made certain changes in institutions,  
15 you would be able to do that? Or, is it his opinion  
16 that conditions of modern life ahead are probably  
17 the sort that you would find you would be able to  
18 do that?

19 COMMISSIONER LEMAN: Yes, that is it.

20 PROFESSOR SAMUELSON: On the whole, I  
21 have been of the opposite opinion, namely that the  
22 people around 1950 in our country who advocated  
23 free money markets should have realized what the  
24 consequences of them would be, namely that free money  
25 markets fluctuate a great deal. For example, the  
26 price of cocoa will go from a ten-fold price in  
27 a really free market to one-tenth. The price of  
28 natural rubber in a truly free market will oscillate  
29 a great deal. I have thought that with changing  
30 fortunes of different countries, and changing degrees





1 of investment opportunities over decades, a flexible  
2 monetary policy, if it is doing what it should,  
3 would probably involve us in a considerable range  
4 of interest rate changes. But I did not regard  
5 them as disastrous.

6 COMMISSIONER LEMAN: Not on a narrow  
7 range, anyway?

8 PROFESSOR SAMUELSON: No. But I do  
9 not speak with any conviction on this because  
10 I have not thought recently about it.

11 COMMISSIONER LEMAN: Mr. Gibson, was  
12 not Dr. Bernstein basing his argument on a  
13 mathematical basis? Did he not say that he  
14 thought 90 per cent of the desired result came  
15 from that narrow range?

16 COMMISSIONER GIBSON: Yes, that is correct.

17 COMMISSIONER LEMAN: That you were just  
18 chasing the last 10 per cent of these wider swings.

19 PROFESSOR SAMUELSON: I agree with that  
20 interpretation. I believe that in this regard  
21 primarily, and perhaps only, when we economists  
22 henpeck the Federal Reserve, one of the places  
23 where they are most vulnerable is that they do  
24 over-do things. Although there are no announcements  
25 to this effect, they slipped into the habit of  
26 thinking that they could spit against the wind and  
27 not take anticipatory action. A little like the  
28 old Dow theory of equity price forecasting, you  
29 did not try to anticipate the turn, but you tried  
30 to recognize the turn not too long after it occurred.







1 I think that was generally their philosophy because  
2 of some disillusionment with economic forecasting,  
3 including certain errors in my profession made right  
4 after the war that ought not to be glossed over.

5 I think this worked badly in the United States in  
6 the post-war period because we have had a number  
7 of interesting business - cycle patterns.

8 Our upper turning points, when we go  
9 from a rise to a fall, have not been sharp peaks.  
10 They have been long, meandering tops. An example  
11 of that would be from June of 1956, roughly, until  
12 the middle of 1957. The economy was not falling,  
13 but it was scarcely rising at all. The same thing  
14 happened in the first part of 1960. We now date the  
15 turning point at May, but from January on the system  
16 was really levelling off. I almost think that I  
17 detect in the present situation of the American  
18 economy that sort of thing.

19 Now, in the past, fortunately not this  
20 time -- I hope not this time -- the Federal Reserve  
21 has just kept tightening even through that period,  
22 though most businessmen felt that the bloom was off  
23 the boom. I take it that that was an error in  
24 judgment. Well, it was an error in judgment. In  
25 other words, using hindsight, as they had to do in  
26 the stream of history, it was not obvious to them  
27 or to me at the time as it now appears to be obvious.  
28 But even at the time I would have felt, I think,  
29 that there was an error in judgment. If that is  
30 what Dr. Bernstein means, that that last pound of







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1 flesh which the Federal Reserve has tended to take  
2 out of the market has been a mistake, I agree. But  
3 his is probably a two-sided accusation, namely that  
4 you should also not flood the market as we did in the  
5 earlier recessions, where the bill rate got down to  
6 about one-half of one per cent. I think it is  
7 interesting to compare what happened in the 1960-61  
8 recession and in the rather weak 1961-62 recovery  
9 with the bill rate. It was never permitted to go  
10 down below 2 per cent. You could not see from any  
11 announcement of the Federal Reserve that its policy  
12 was to keep it going down below 2 per cent, but it  
13 now looks as if it was a visible hand which kept  
14 it from going below. I think that is quite under-  
15 standable, but understandable only for one reason,  
16 namely the international balance of payments  
17 situation. It is not that it would have been a  
18 bad thing, in my judgment, if it had gone lower  
19 from the purely domestic viewpoint, but given our  
20 balance of payments problem and the competitive rate  
21 in London, and so forth -- and this is a consideration  
22 which for Canada will always be, probably, more  
23 important than for the United States, because you  
24 have a smaller and more open economy -- then it was  
25 a wrong thing.

26 I do not think it was a wrong thing for one  
27 of the reasons which Chairman Martin gave in recent  
28 legislative hearings, namely that it is a bad thing  
29 to flood the market -- that a sloppy market is  
30 something which does nobody any good and which ought





1 to be avoided. I have commented at some length in  
2 my submission on that point. In particular, if you  
3 are not confident that the recession is a short one  
4 and that it is in the social interest to deepen  
5 capital and to move down the diminishing returns  
6 schedule of rate of return to capital, what you have  
7 to do is to break through conventional notions. That  
8 is why monetary policy was so ineffective in the  
9 1930's. People may believe that the long-term rate  
10 for the 1930's was as much below the 1920's as in  
11 retrospect it should have been. This flooding of the  
12 market resulted in excess reserves for the commercial  
13 banks, which resulted in bill rates which got down  
14 to three-eighths of one per cent. No, three-eighths  
15 of three-eighths of one per cent. There was a time  
16 when you had 37 cents on \$1 million. And there were  
17 also times when there were negative rates. That  
18 is hard to understand except that there were certain  
19 bidding privileges. It was in such a way that I was  
20 told that a \$1 million 90-day bill would expire and  
21 would not be brought to the treasury for payment.  
22 I asked how that was, and the answer was: "Do you  
23 know a better way to hold a million dollars than in  
24 a treasury bill?"

25 Such rates, of course, were not themselves  
26 accomplishing anything, but if you look at the  
27 Treasury Curve relating interest rates and bond  
28 maturities, you would find that it was slowly  
29 shifting down all during the 1930's. There was  
30 nothing at all wrong in this but the astute bankers





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*Toronto, Ontario*

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1 were going to the long end because they did not think  
2 that rates would harden back to the level of the  
3 1920's as much as the more inert bankers thought.  
4 But the inert bankers finally followed the astute  
5 bankers, and this gradual process was helped along  
6 by the most tremendous gold inflow in recorded  
7 history, a tribute mostly to Herr Hitler. Still  
8 you could not get long-term rates down very fast.  
9 I do not think you could have done it at all with  
10 a bill rate held at 2 per cent during that period.  
11 This is an occupational disease with  
12 money manipulators. They do not like things to  
13 get out of control or to have a sloppy throttle.  
14 Then they worry about what would happen if everybody  
15 suddenly spent their money and accelerated velocity,  
16 and all this affects their sleep. Central bankers  
17 are especially prone to that sort of nightmare.  
18 That is why they engineered an increase in reserve  
19 requirements, practically doubling them in 1936  
20 and 1937. One of the naive arguments made was  
21 they were excess reserves and were not needed.  
22 Indeed they were above required reserves, but that  
23 does not mean that the prudent banker did not want  
24 them, and that he would not want to re-instate them  
25 in some degree. So we had some monetary tightness,  
26 which came as a surprise to some central bankers,  
27 and this played its role in our 1936 and 1937  
28 turning point.  
29 In principle, I do not like a sloppy  
30 market, but if that is the way in which we bring







1 pressure on long-term rates at a time when you want  
2 to bring pressure on long-term rates, let the central  
3 bankers stand it. That is what they are paid for.  
4 The world is made not to give them an easy time;  
5 their purpose in life is to suffer pain for a good  
6 cause. But I do not think it is likely that we  
7 will soon meet a great depression with such rates.  
8 I believe that Dr. Bernstein is absolutely right that  
9 conditions have changed, and that you will not have  
10 the same shock in confidence and break in trend.  
11 But I do believe that there will be lots of times  
12 when you will not want to have a narrow range for the  
13 bill rate. If you do have international reasons,  
14 then I would hope very much that you would not stick  
15 to bills only or bills preferably in policy. I had  
16 meant to enlarge on that and mention it in my  
17 submission, but I did not have time to do so.

18 COMMISSIONER GIBSON: Professor Samuelson,  
19 you have pretty well answered the questions I asked  
20 you. You might want to say a little more about it.  
21 We have had presented to us two pretty contrasting  
22 points of view, one by Professor Lundberg of Sweden,  
23 and the other by certain people from the United States.  
24 The view of the one, the one which Professor Lundberg  
25 called the Swedish view, was that a willingness to  
26 intervene in the process of monetary transfers in  
27 a lot of places was either to make it more easy or  
28 more difficult, but not to have any sort of fixed  
29 rule as to how to do it, and to work over a very wide  
30 area. In contrast to that there was the sort of





1 bills only or bills preferably approach of the United  
2 States, with its philosophy of non-intervention  
3 elsewhere. I take it from what you say that you are  
4 at least somewhere between these two approaches. You  
5 have expressed the feeling that an unconventional  
6 approach on the part of the central bank would be  
7 desirable, and you have given us a number of  
8 illustrations.

9 PROFESSOR SAMUELSON: I would say that  
10 in principle I am closer to Professor Lundberg. I  
11 am especially closer to Professor Lundberg in terms  
12 of drafting permissive legislation.





11. I take it from what you say that you are



1 I would hope that in most years and in  
2 most times that most of the operations of the central  
3 bank would be conventional ones, and for purely  
4 technical reasons I think it is understood that most  
5 operations all the time will be in short-term bills.  
6 I would even go beyond that and say that many times  
7 there would be no particular reason against doing almost  
8 all your operations in bills. However, there are lots  
9 of times when I think that would do harm, and it  
10 should not be regarded as a violation of character-  
11 istic central banking practice or of sentimental  
12 human freedom to depart from that.

13 There is not a long tradition in our  
14 country of bills only. We always have to forge  
15 traditions in our country and to do so on a fast  
16 basis. Prior to 1952 there was no such tradition.  
17 Then a Select Sub-committee meeting in private and  
18 unknown to and independent of most academic economists,  
19 came out with the notion that true central banking  
20 traditions required operations in bills only.—Until  
21 that announced effect came, most of the world did not  
22 know about it. I do not think it is true.

23 The Federal Reserve has recently departed  
24 from that practice. I should not exaggerate before  
25 you the benefits that came in terms of the Treasury  
26 structure from this; but the effects, such as they  
27 were, were in the right direction.

28 COMMISSIONER GIBSON: Professor Samuelson,  
29 would you care to say a word about the opposition  
30 that has been expressed with respect to broader market



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1 operation policies and the claim that you do not get  
2 as smooth marketing operations as you otherwise  
3 would.

4 PROFESSOR SAMUELSON: I do not agree that  
5 such operations are distorting. You get certain breaks  
6 in the sort of smoothness you want to have; but I  
7 do not think one can start out with the axiom that  
8 it is correct to intervene at the shortest end and  
9 let the market adjust itself, or that it follows  
10 from this that (1) you will get the most efficient  
11 market and (2) any departure from it is a philosoph-  
12 ically indefensible infringement of freedom. We  
13 have crossed the Rubicon and know that money will  
14 not manage itself and that the nation has an interest  
15 in a stock asset policy. But this has effects and  
16 I do not want to advocate indiscriminate interference  
17 with the long-term markets. An example would be  
18 the present time when there is a genuine conflict  
19 between domestic purposes and the international  
20 balance of payments. If we were a small country  
21 and had a floating exchange rate the sharpness of  
22 that dilemma would be reduced.

23 In brief, if I understand most of the  
24 spokesmen of the Federal Reserve who advocate the  
25 position that I am criticizing, they do not go so far  
26 as to say it should not be done, but they say it  
27 should not be done by the central bank. The debt  
28 management is a legitimate function of the Treasury  
29 and there should be a certain clearing of the maturity  
30 structure by the Treasury, but this should not be done



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PROFESSOR SIMONSON: I do not agree that

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structure by the Treasury, but this should not be done



1 within the tent of the central bank.

2 Since I am not enamoured of the analogy  
3 of two people tugging at the steering wheel, I think  
4 this is a part of the asset policy which could be done  
5 in either tent or both, and in our case I would say  
6 both. I think the Federal Reserve is in a much  
7 better position to give us the kind of debt structure  
8 we want than is the Treasury alone. We should have a  
9 differential maturity policy of the debt in order to  
10 help stabilize business activity. It is not a strong  
11 nudge, but it is a nudge in the right direction.  
12 I find it amusing that the barefoot Populists in  
13 Congress should oppose central banking and think  
14 the best interest rate is a low one for debt management  
15 and other reasons. They are almost identically in  
16 the same analytical position as are the purists for  
17 bills only. They both pooh-pooh the differential  
18 effects on aggregate demand that would come from  
19 having a varying maturity of debt structure.

20 They say you cannot offset the interest  
21 rate differential anyway, that the market is just  
22 going to snap back to its original place.

23 I am very happy to be in on either camp  
24 on that position. I will even go further in support  
25 of unconventional credit policies which I think in  
26 certain circumstances ought to be followed. I admit  
27 it is disputable whether the central bank ought to do  
28 them or whether you should have the central bank not  
29 do them, and then have Ersatz central banks do them.  
30 What I do not want to have is this: If the central





of two people together at the steering wheel, I think  
there is a part of the road policy which would be done  
in either form or both, and in our case I would say  
that I think the Federal Reserve is in a position  
better placed to give us the kind of help which  
we want than the Treasury does. We would have  
a different view of the policy of the bank in order to  
help stabilize the economy. It is not a simple  
matter, but it is a matter in the right direction.  
I think it would be a good idea to have a  
committee to study the situation and make  
the best possible use of the law and the power of the  
and other agencies. They are likely to be helpful in  
the case of the Treasury and the Federal Reserve.  
I think they are likely to be helpful in  
efforts on a large scale which would be done  
having a variety of other measures.  
They are not enough to do the job  
more effectively, and the more we do  
better to get back to the old place.  
I am very happy to be in an office  
on that point. I will have no further to say  
on that point. I think I think  
it is important to have the central bank  
and on whether you should have the central bank  
do that, and then have the central bank do that.  
and I do not want to have it that. If the central



1 bank is not to do it, I do not want it to be in a  
2 position to negate and inhibit the ersatz central  
3 banks that the populace in its considered judgment  
4 sets up to accomplish these aims. I think we need  
5 the privileges of money and credit creation to back  
6 up these unconventional acts.

7 COMMISSIONER GIBSON: Do you think as  
8 a practical matter that debt management can be used  
9 significantly in an anti-cyclical way?

10 PROFESSOR SAMUELSON: Yes, if you are  
11 willing to pay the price; and the price you have to  
12 pay is that such a step will have a significant  
13 effects upon the interest rate structure. Another  
14 price you have to pay is that it changes the amount  
15 of debt service charges. I never have thought that  
16 the duty of a Secretary-Treasurer or of a chancellor  
17 is to float debt at the lowest possible rate and cater  
18 to his vanity and have new issues that go over the  
19 top. A new issue that goes off the starting line  
20 too fast has been improperly priced. Nor is it the  
21 job of the Secretary-Treasurer to desist from  
22 spending money. It is his duty to spend money in  
23 good causes and to desist from spending money in  
24 bad causes.

25 Part of the price we pay for a differential  
26 asset structure yield curve is that the debt service  
27 charges, which are about \$10 billion in the present  
28 American budget, will be enlarged by this fact.  
29 I would not pay a cent too much for debt service  
30 without getting the quid pro quo, but I would pay



There is no fee for this. I do not want to be in a position to receive any money for the same. I have been told that the fee is in the consideration of the matter. I think we will have to wait for the money and then we will have to wait for the money.

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1 in this form for benefits of stabilization.

2 COMMISSIONER GIBSON: But it is sort of  
3 a conservative pattern of debt management from the  
4 standpoint of the treasury to borrow money as  
5 economically as one can and to have a series of  
6 maturities that do not expose you to too much, in any  
7 given year, of an embarrassing situation?

8 PROFESSOR SAMUELSON: I do not think  
9 that the last point you made about staggering your  
10 maturities in a convenient way is a conservative  
11 position that thought to be criticized.

12 COMMISSIONER GIBSON: No. That is what  
13 I am getting at.

14 PROFESSOR SAMUELSON: That is a perfectly  
15 sensible device, but I think it is wrong to believe  
16 that the purpose of the Secretary-Treasurer is to be  
17 able to have long periods of time when he does not  
18 come to the market at all. It is the purpose of  
19 any bank to be prepared to pay out money all the  
20 time to its depositors, and it does it. It is the  
21 purpose of any modern chancellor of any modern  
22 treasury to be always turning over the debt, a large  
23 part of the debt, even if you think there should  
24 be some long debt; and in doing this, no one should  
25 be regarded as doing anything extra and deserving  
26 time and a half pay. That is just part of his job.  
27 Nor should one wonder what would happen if the market  
28 would not take the short-term debt; we all live by  
29 promises we make to each other. There is no day of  
30 liquidation and there will not be a time when



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1 everybody will refuse short-term debt. I myself  
2 see absolutely no reason why the central bank  
3 should not be permitted to buy debt directly from  
4 the Treasury.

5 COMMISSIONER GIBSON: But you do not  
6 see any conflict from the Treasury's point of view  
7 in trying to get debt management to gear a little  
8 more to an anti-cyclical position?

9 PROFESSOR SAMUELSON: No. I do  
10 recognize that just as there are historical patterns  
11 in the personality of central bankers there are  
12 historical patterns with respect to chancellors and  
13 secretary-treasurers; and there has been a tendency  
14 for them in many past epochs to be much too worried  
15 about service charge reduction, in the belief that  
16 they have been clever fellows if they were able to  
17 float the debt at 2 per cent instead of  $2\frac{1}{2}$  per cent.  
18 I say they are clever when they float it at 4 per  
19 cent when it should, for stabilization reasons,  
20 be floated at 4 per cent. They are also clever  
21 fellows if they adjust the maturity patterns to suit  
22 insurance companies and anybody else in the market,  
23 just as anybody who has a product which accommodates  
24 his customers' needs is able to make or save a little  
25 money by that device.

26 COMMISSIONER GIBSON: Thank you very much.  
27 I think I have asked Professor Samuelson enough  
28 questions for the moment, sir.

29 THE CHAIRMAN: Are there any other questions  
30 on this subject?





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1 COMMISSIONER BROWN: I should like to  
2 pursue this question of the control of non-member  
3 banks. You showed very clearly that as the number  
4 and variety of these banks increase, the leverage factor  
5 with respect to the control of the central bank  
6 decreases. You say you are in favour of having  
7 more direct controls available to the monetary  
8 authorities. What sort of controls were you  
9 thinking of?

10 PROFESSOR SAMUELSON: If I could write my  
11 own ticket for my own constitution I would want  
12 uniform rates supplied to non-member banks of the  
13 Federal Reserve System. Of our 14,000-odd banks I  
14 think probably four or five thousand are members  
15 of the Federal Reserve System and the bulk are not,  
16 but I guess they are much smaller, commercial banks  
17 and in terms of total value it is probable that we  
18 control most of this. But there is still some  
19 leakage. There has even been some discussion about  
20 big banks getting out from under the Federal Reserve.  
21 The minute any big bank does do it, the Federal  
22 Reserve will close the opening to them. It is a  
23 freedom they have as long as they do not use it, but  
24 if you get three big wholesale New York banks and  
25 one in Chicago not being members of the Federal  
26 Reserve, as some people have begun to suggest, then  
27 I think this minor problem would become a major  
28 problem and we would move in. I think comparable  
29 reserve rates should be specified for mutual savings  
30 banks, for workmen's co-operative institutions,



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Nethercut & Young

Toronto, Ontario

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1 for federal chartered savings and loan associations,  
2 wherever they are not already comparable to reserve  
3 rates for time deposits of commercial banks. In  
4 that sense these near moneys are going to be  
5 controlled. I also think there are times when you  
6 would want to raise the reserve rate; at the present  
7 time for commercial banks, a savings deposit or time  
8 deposit in a commercial bank has a required reserve  
9 rate of 5 per cent. That is as against more than  
10 12 per cent on demand deposits.



March 1934  
New York

The Federal chartered savings and loan associations,  
which are the only ones that are insured by the  
Federal for time deposits of commercial banks. In  
that case these are not insured and would be  
controlled. I also think there are times when you  
would want to utilize the Federal notes; at the present  
time the commercial banks, a savings account on the  
part of a commercial bank is a regular account  
and of a per cent. That is an account with  
12 per cent on demand deposits.

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1                   We have been having a substantial shift  
2   into time deposits. In a way this is fortunate  
3   because the ordinary kind of deposits have been  
4   languishing, and under our monetary policy we would  
5   be in real trouble if this were not compensated for.  
6   But, suppose the ordinary demand deposits had been  
7   growing at an ordinarily satisfactory rate, and you  
8   begin to get this movement into time deposits so  
9   that the total was growing at the rate of 7 per cent  
10   a year and the economy really needed a growth of  
11   only 4 per cent? In such a case I would like to  
12   see this 5 per cent rate on required deposits  
13   increased to 7 per cent.

14                  No banking trade association would ever  
15   agree with me, and in no testimony before Congress  
16   by the banking community, or in their submissions,  
17   would there be agreement because to the individual  
18   banker it looks as though it is a wasteful asset.  
19   They would say: "You are requiring us, in a  
20   punitive way, to hold a non-interest bearing asset."  
21   The bankers want to hold only earning assets. To  
22   an individual banker a capital savings bank competing  
23   with a commercial bank is a horrible thing, and that  
24   is why you cannot let bankers run the central banks.  
25   You cannot let bankers' testimony dominate the  
26   testimony before a commission of this sort. You  
27   cannot have on a commission of this sort the good,  
28   reliable bankers. If you do, you put them in an  
29   uncomfortable position because they are traitors to  
30   their class if they say some of the things that have





1911

1. The first of the three main branches of the tree is the trunk.

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1 to be said, although a very respected banker who  
2 has made his career and who is above it all could  
3 be one of many representatives on a commission like  
4 this.

5 I speak with some feeling on this because  
6 we have just had a report to the Controller of the  
7 Currency by representatives of the national banks,  
8 and I am sorry to say that their recommendations  
9 were only too predictable. There are not many of  
10 them, you will find, who will run against the near  
11 term interests of the national bank as seen by a  
12 national banker, and you cannot criticize them for  
13 that.

14 I am not clear in my own mind as to what  
15 I would do about financial intermediaries such as  
16 finance companies, life insurance concerns, and so  
17 forth. It could be the business of a special  
18 commission in my country, if Congress and the  
19 Executive thought there should be some control  
20 over financial intermediaries, to devise a set of  
21 controls that could be put on at any time. It is  
22 a difficult thing, and I am not prepared to make  
23 recommendations.

24 COMMISSIONER BROWN: Have you any thoughts  
25 about direct controls on their operations?

26 PROFESSOR SAMUELSON: When I speak of  
27 direct controls by central banks in this submission  
28 I am referring almost always to direct, even-handed  
29 controls as against the other medium of direct  
30 controls such as fiats. The only one I recognize



1891

1891

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1 as a fiat of the conventional central bank is the  
2 ability of the Federal Reserve to change the required  
3 reserve ratios. That is a fiat, although it is  
4 applied even-handedly among different banks, and it  
5 has been used in recent years in lowering reserve  
6 requirements for structural reasons, and otherwise.

7 I agree with the position of Alan Sproul  
8 in his testimony before you when he said really  
9 direct controls have short-run potency, and should be  
10 used sparingly for emergencies. We have had three  
11 such in our recent history -- control over stock  
12 margin borrowing; control over consumer credit;  
13 and control over house mortgage terms.

14 I think the effects of mortgage rate  
15 payment controls are very strong in the short run.  
16 In the longer run people begin to find lots of  
17 different ways of getting around these controls.  
18 I do not mean evasion, but I mean that they take  
19 avoidance procedures which are not necessarily  
20 illegal.

21 I think that these are potentially  
22 tools of social policy, but most Federal Reserve  
23 people do not. However, I do think you could save  
24 them for emergencies, and the same thing could be  
25 said about wage controls and price controls. It  
26 is very understandable that we should have resort  
27 to such measures on some occasions. They work well  
28 in the short-run, and, therefore, I would not want  
29 to dissipate them when there are not emergency  
30 conditions because they can be used up too easily.





1 My general inclination is that such  
2 controls could be useful when you have to deal with  
3 insurance companies. In principle, being able at  
4 the right time to control what they do about certain  
5 parts of their lending, sounds like a good added  
6 implement in the arsenal of general credit control.  
7 But I think they should be used very sparingly,  
8 and I would not know how to draft the legislation  
9 for that purpose.

10 COMMISSIONER MACKINTOSH: Suppose you  
11 have established reserve requirements in the range  
12 of these near banks. Would you then expect an  
13 open market policy to operate sufficiently on them,  
14 or would you, in their case, depend more on changing  
15 reserve ratios as a method of controlling them?

16 PROFESSOR SAMUELSON: I think that  
17 open market operations primarily would affect  
18 them, so we would just have widened the potency  
19 of the open market operations. I am not clear in  
20 my own mind as to how quickly the reserve ratios  
21 I would use for the commercial banks, or for these  
22 near banks, would operate, so I am not able to give  
23 you an answer.

24 COMMISSIONER MACKINTOSH: I do not  
25 know much about these things, but it would seem to  
26 me that big savings banks, and so on, are very  
27 vulnerable to open market operations, but if you  
28 stretch the spectrum to the credit unions then  
29 probably the ripple in the open market operations  
30 does not get out to them.





...the right time to do so, and I think they would be very helpful in the general development of the area. I think they would be very helpful in the general development of the area. I think they would be very helpful in the general development of the area.

...I think they would be very helpful in the general development of the area. I think they would be very helpful in the general development of the area. I think they would be very helpful in the general development of the area.

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1 PROFESSOR SAMUELSON: One of the ways  
2 the system adjusts itself to the open market  
3 contraction, and avoids the desired effect is to  
4 move out to these intermediaries. In other words,  
5 money begins to move into the near banks.

6 There is a natural recourse to these  
7 as interest rates get higher. There is a tendency  
8 for money to go into direct savings deposits. I  
9 do not feel I know sufficient to give a response  
10 to your question.

11 COMMISSIONER MACKINTOSH: You would  
12 not go into anything like special deposits?

13 PROFESSOR SAMUELSON: I would at certain  
14 times. I would prefer that to more arbitrary methods  
15 of credit rationing. I think, for example, the  
16 Dutch system which was described to you by  
17 Dr. Holtrop sounds better than some of the  
18 instructions given by the Chancellor in the United  
19 Kingdom in the post-war period to do things that  
20 the banks had either not done or things which, when  
21 they did do them, they did in an arbitrary way.  
22 This would be a more even-handed way of spreading  
23 matters.

24 COMMISSIONER BROWN: May I switch to  
25 a slightly different topic. You described monetary  
26 policy as controlling stocks, and fiscal policy as  
27 controlling flows, and you described in general  
28 terms that there had to be a certain relationship  
29 between these two. I wonder if you could give us  
30 a little more detail on how you think this should



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1       come about in actual operations?

2                   PROFESSOR SAMUELSON: Well, let me  
3       approach it by way of a current example. There is  
4       a considerable body of opinion in the United States  
5       that there ought to be a tax rate reduction.  
6       President Kennedy announced a month or so ago --  
7       in August, I think -- that he was not going to  
8       ask Congress for a tax rate reduction within the  
9       calendar year 1962, but that he did intend to  
10      ask for such a rate reduction in 1963.

11                  There is a great deal of support for  
12      that position from the unions and the poor people,  
13      and there is also considerable support for it from  
14      representatives of business. The latter group in  
15      particular are often much impressed by the advice  
16      given to us by Europeans and also some bankers  
17      within our own country that it is all right to  
18      have tax rate reductions which will involve an  
19      increased deficit in the short-run provided it  
20      is financed out of "real savings". This is  
21      interpreted to mean "provided it is not sold to the  
22      banking system". I think it would be much more  
23      germane to say "provided it is not sold to the  
24      central banking system". It is a great illusion  
25      that if you sell a bond to the banking system  
26      that is inflationary.

27                  It is almost the reverse of the truth,  
28      except in times when there is a great excess of  
29      reserves, that when you are selling to the banking  
30      system it uses up its excess reserves which it would





1 not have used otherwise. During most of the post-  
2 war period whenever a bank bought a bond it had to  
3 refuse a borrower, and so the way we would try to  
4 deflate the over-enthusiasm of the post-war boom  
5 was precisely by getting particular banks to buy  
6 government bonds. But, if the central bank buys  
7 the bonds and creates extra reserves then that is  
8 expansionary. So, it is said it is all right to  
9 have a deficit provided that it is counter-balanced  
10 by a stock set of moves -- this is a move which  
11 is expansionary, and it must be counter-balanced  
12 by a set of moves that are contractional to some  
13 degree. I have not seen any intelligent discussion  
14 as to what in the world this is supposed to mean.

15 COMMISSIONER BROWN: Perhaps we could  
16 have such a discussion now.

17 PROFESSOR SAMUELSON: Well, you do me  
18 too much honour, but I will comment on the matter.  
19 If it means that we really should not have more  
20 expansion for international reasons, and that when  
21 the government creates expansion by reducing tax  
22 rates, the central bank has to engineer an increase  
23 in real savings just big enough to offset that,  
24 then I must say I cannot see the purpose of it.

25 This is a very unpopular policy. The  
26 country has grave doubts about it. Why should we  
27 add to a deficit and do all of the bad things of  
28 life just for the purpose of getting no fruit from  
29 it at all?

30 I take it that not quite that is meant







1 by the people in Zurich who give us this good advice.  
2 Probably what is meant is that if an expansion  
3 follows from this the central bank ought to take  
4 this into account in its degree of ease or tightness,  
5 but that says nothing. The same thing would be true  
6 if there had been a private and spontaneous  
7 recovery that was stronger than what we now have.

8 In an accounting sense our Department  
9 of Commerce will always register savings equal to  
10 investment and they do that even in periods of  
11 greatest inflation. In 1947 when we had the  
12 greatest peacetime inflation in recent years, which  
13 was a left-over from the method of financing the  
14 war, there was always a balance between savings  
15 and investment. It comes back to the same kind  
16 of notion of neutral money -- that the system has  
17 a way of behaving in barter terms which is desirable,  
18 and that the real job of the central bank is to  
19 try to replicate that condition.

20 That was my point in the illustration  
21 of stock being able to flow and inter-act. Leaving  
22 out the international situation for the moment, the  
23 effect of this primarily would be that we encourage  
24 consumption expenditure by private individuals and  
25 by the government, and we discourage investment  
26 expenditure. This effect comes about because  
27 the conscience of the system with respect to the  
28 price level is the central banker and he can always  
29 impinge on investment interest rates and investment  
30 movements to do what he can to wipe out the excesses



in the course of the year and that in this regard, it is  
probably not far from the truth that if an expansion  
of the money supply is needed, it will be required.  
This is not to say that the degree of expansion or contraction,  
but that some expansion. The same thing would be true  
if there had been a private and spontaneous  
movement that was stronger than what we now have.  
It is accordingly necessary for the Government  
of Commerce will always have to maintain a close  
relationship and try to keep it in balance with  
the market. In fact, we have had the  
Government sometimes intervened in the money market, which  
was a long time from the market of the money market.  
But, there was always a balance between the money  
and the market. It comes back to the same thing  
in terms of money market -- that the money market  
is a way of keeping in balance the money market in the  
and that the money market is the money market in the  
and the money market is the money market.  
That was the result in the money market.  
It is not only the money market and the money market, but  
and the international situation in the money market, and  
effect of the money market would be that we encourage  
the money market by private individuals and  
by the Government, and we encourage investment  
expenditure. This is not to say that because  
the expansion of the money market is the money market in the  
money market in the money market and we can always  
the money market in the money market and investment  
movement to do what we can to wipe out the excess





1 of fiscal policy. This results in a bad mix from  
2 the standpoint of growth. If you think we have had  
3 enough growth and do not want any more then that is  
4 a possible position. But, you should not let the  
5 procedure taken by the government, which may make  
6 one kind of error, and that taken by the central  
7 bank, which may make another kind of error, go on  
8 in the hope that the two will cancel out. This  
9 illustrates the importance of the stock and flow  
10 analysis.

11 I would not agree with one of your  
12 eminent central banking witnesses in his analysis  
13 of just what was neutral in terms of deficit  
14 financing by one method and deficit financing  
15 by another method. He listed half a dozen  
16 situations and described which of those was neutral  
17 in respect to purchasing power. I do not agree,  
18 simply as a matter of technical fact. In some  
19 of his cases I thought the stock effects were  
20 not big enough to wipe out the flow effects.

21 Let me illustrate that with respect  
22 to my own country. It is sometimes thought that  
23 if you pay off the debt by a surplus this step  
24 is not deflationary on the system because, after  
25 all, when you pay off the debt somebody gets the  
26 money and he can put it into investments. If  
27 there were a certain conservation law as to  
28 purchasing power which said that everything  
29 circulates at the same rate, and that this money  
30 would be incidentally re-invested, then that view



of fiscal policy. This results in a net tax



1 would be correct.

2 But, unless the central bank deliberately  
3 used the paying-off of the debt as an occasion for  
4 easing money, the budgetary surplus would be a  
5 contractional influence. To my mind, flows and  
6 stocks are inter-acting at every point in the  
7 symphony -- and I hope it is not a discordant  
8 symphony.

9 I am not sure that I have answered your  
10 question, but I have used up some time.

11 THE CHAIRMAN: We will adjourn until  
12 2.00 o'clock.  
13 ---Luncheon adjournment.





18.  $\frac{1}{2} \log \frac{1}{2} = -\frac{1}{2} \log 2 = -\frac{1}{2} \times 0.3010 = -0.1505$

... and I had a sleep

1. The first part of the paper is devoted to a review of the literature on the topic.



1 --- Upon resuming at 2.20 P.M.

3 THE CHAIRMAN: Mr. Brown?

4 COMMISSIONER BROWN: Mr. Chairman, just  
5 before lunch we were starting a discussion of fiscal  
6 policies, fiscal techniques, and I would like to  
7 get Professor Samuelson's views on the relative  
8 advantages and disadvantages of fiscal policies  
9 aiming at changes in the tax level as against  
10 changes in government expenditures. Perhaps you  
11 would start on that general topic?

12 PROFESSOR SAMUELSON: First, I would  
13 say that a dollar of government expenditure on  
14 goods and services is expansionary, and a dollar  
15 of tax rate reduction is expansionary, but there  
16 probably is a slightly greater amount of expansion  
17 to be expected from a dollar of government  
18 expenditure on goods and services than from a  
19 dollar of remission of tax revenue.

20 I emphasize this because if you were  
21 simultaneously to increase government expenditure  
22 at a given level of national income by \$5 billion,  
23 and match it completely by a tax rate increase of  
24 \$5 million, I don't think the total effect would be  
25 neutral. There would be a slight expansion from  
26 having the budget balanced if it happened at a  
27 high level of activity, because at the high level  
28 of activity the government is using up resources  
29 and keeping it high. Likewise, a reduction of  
30 government expenditure on goods and services by



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1 several billion dollars, if completely matched by  
2 a tax reduction would, on the whole, not be neutral.  
3 But the difference between them is of course minor  
4 as compared to the fact that they both operate in  
5 the same direction.

6 For practical stabilization purposes,  
7 some objects of government expenditure, such as long  
8 term public works, have the defect that they take  
9 a long time to be planned, and a long time to be  
10 carried into effect -- there is a delay in land  
11 acquisition and so on, but finally you begin to  
12 put out money for the use of resources and this  
13 builds up in a characteristic pattern as the school  
14 or building progresses.

15 Now, by the time a great deal of money  
16 is actually coming onto the market for labour and  
17 for materials, a short recession may have been long  
18 behind you and this money may be coming onto the  
19 market just at a time when you already are in a  
20 vigorous expansion and don't need more resources.  
21 So there has been a certain amount of disillusionment  
22 among economists about placing great reliance upon  
23 public works for short term practical stabilization.

24 I am afraid that monetary policy has  
25 somewhat the same defects, particularly if we  
26 examine the induced private construction expenditure,  
27 say, in the building of a factory or a hotel which  
28 comes from expansionary central bank action. First,  
29 the central bank eases the reserve position, brings  
30 down interest rates and increases the availability





1 of credit. Finally, the promoter makes his plans --  
2 and it takes about as long to build a private  
3 structure as it does a public structure. But other  
4 parts of monetary policy can be more closely geared  
5 to the current state of activities.

6 Now, tax reduction and tax increases in  
7 principle should be subject to more flexible  
8 starting and stopping than in fact they are. In  
9 the United States it takes a long time for Congress  
10 to make up its mind about any fundamental change in  
11 tax rates, upward or downward, so there is a  
12 considerable delay.

13 It was for this reason that the Commission  
14 on Money and Credit made a recommendation which was  
15 perhaps the most widely publicized of all their  
16 recommendations, even though it wasn't in the field  
17 of money or credit directly: namely, that the  
18 executive -- the President in our case -- be given  
19 the power by Congress to vary tax rates personally  
20 at his discretion, within certain ranges for certain  
21 limited periods of time and subject to reversal by  
22 resolution of Congress and subject to renewal by  
23 Congress. I believe that such innovation came into  
24 effect in the last British budget. The government  
25 was given the power by Parliament to vary purchase  
26 taxes within certain limited ranges, depending  
27 upon business conditions, and I believe that use  
28 is actually made of that provision.

29 In the case of the United States government,  
30 the Commission made a recommendation -- and





of credit. Finally, we propose to give him  
and to make him the head of the  
committee on the part of the  
points of monetary policy and the closely related  
to the general state of affairs.

Now, we propose to the members of  
the committee to make the  
standing and the committee in the  
the United States is a good thing for Congress  
to make up the part which the committee is  
now working on. It is a  
committee on the

It was the first time that the  
on the part of the committee which was  
between the two which is the result of  
recommendations, which is the result of  
of money to credit. It is a  
executive -- the committee is not to give  
the power of Congress to the committee  
to the committee which is the result of  
limited number of the committee is the result of  
negotiation of Congress and the result of  
Congress. I believe the committee is the  
effect on the part of the committee. The committee  
was given the power by Congress to the committee  
name which is the result of the committee  
from business conditions, and I believe that the  
the general state of affairs.

In the case of the United States Government  
the committee made a recommendation -- and



1 a number of economists have made the same recommend-  
2 ation -- and President Kennedy did ask Congress to  
3 give him that stand-by power, as it was called, but  
4 Congress in its wisdom has not yet seen fit to do so.

5 It is asking a great deal of legislators,  
6 who struggled so long for control over the purse  
7 strings against the kings and despots of former  
8 days, to give up this privilege the first time they  
9 are asked. The House of Representatives doesn't  
10 even like to give it up to the Senate; and since we  
11 don't have a cabinet system of government, the  
12 cleavage between the executive branch and the  
13 legislative branch is much stronger than it is in  
14 the United Kingdom or, I dare say, in Canada. I  
15 am not optimistic that in the near future in the  
16 United States this power will be granted.

17 But such power would increase the potency  
18 and timeliness of fiscal policy and a stitch in time  
19 often saves two or three in the realm of the economist.  
20 It would have been a good thing in my judgment,  
21 therefore, in terms of the situation which we now  
22 have, if President Kennedy had been granted or given  
23 that power when he asked for it.

24 COMMISSIONER GIBSON: You were talking  
25 about the speed which fiscal measures take and you  
26 referred to some parts of monetary policy. Are you  
27 referring to the existing situation?

28 PROFESSOR SAMUELSON: Yes.

29 COMMISSIONER GIBSON: Will you elaborate  
30 more on that? When we were talking about it this



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Mr. [Name]

I think the committee has been very helpful in its work. I think the committee has been very helpful in its work. I think the committee has been very helpful in its work.

It is a very important part of the work of the committee.

I think the committee has been very helpful in its work.

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I think the committee has been very helpful in its work.





1 morning we didn't get into this question of lags  
2 very far.

3 PROFESSOR SAMUELSON: Well, that part  
4 which impinges upon very durably constructed projects  
5 which last a long time in their gestation period  
6 and in the planning period, I think would be subject  
7 to the same defects as in the case of fiscal policy;  
8 that part which had to do with, say, the availability  
9 of credit -- an example would be in the United  
10 Kingdom during the Maudling Chancellorship when  
11 there was a release of a block of war savings,  
12 was it special deposits, -- would begin to be felt  
13 quite quickly and might begin to be felt in  
14 connection with short run decisions.

15 Another example would be if the central  
16 bank has any power over hire purchase; that can be  
17 changed, and I think the effect would be seen  
18 almost in the next month's statistics. This is  
19 getting to be a little bit outside the conventional  
20 range of central banking policy, but it is a bit  
21 of ammunition which I would like to see in the  
22 arsenal of the central bank, but not with the  
23 expectation that it would be used all the time or  
24 even often. That is the kind of power I had in mind.

25 COMMISSIONER GIBSON: Are you almost  
26 suggesting that the vigorous action or sharp change  
27 in monetary policy will in part be felt fairly  
28 quickly because of the fact of availability having  
29 an effect on other markets, but what about the  
30 gradual changes; there is quite a lag?



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...in the ... of the ...

very far.

THE HONORABLE SAMUELSON: Well, this point

which implies upon very durably constructed projects

which last a long time in their gestation period

and in the planning period, I think would be subject

to the same ... as the ...

any point which had to do with, say, the ...

of course -- an example would be in the United

States during the ...

there was a release of a flock of ...

was a special ... -- would ...

quite quickly and might begin to be felt in

connection with some new ...

Another example would be in the ...

back has any power over time ...

... and I think the effect would be ...

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of ... which I would like to see in the

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... that it would be used all the time or

even ... That is the kind of power I had in mind.

...: And for almost

... the various ...

in monetary policy will in part be felt fairly

quickly because of the fact of availability having

an effect on other markets, but what about the

... in the ...



1 PROFESSOR SAMUELSON: Yes. I mentioned  
2 earlier that sometimes you have to keep pushing short-  
3 term rates for a long time in order to have them  
4 seep through.

5 I was thinking of a sentence in Lord  
6 Cobbold's testimony where he said that in his  
7 experience it took about six months to get a change  
8 in the climate of expectations of the money market,  
9 and perhaps for the policy to become effective.  
10 I am sure that no single figure can be specified  
11 with any accuracy, but these things do involve a  
12 great deal of time.

13 There is another slight asymmetry  
14 between the delays involved in monetary policy and  
15 in fiscal policy that has to do with the following  
16 matters. A tax reduction or tax rate increase is  
17 a dramatic "once and for all" thing; it usually  
18 takes time to do something dramatic and "once  
19 and for all".

20 The central bank, as Mr. Sproul mentioned  
21 in his submission to you, can probe and retreat.  
22 This is not to deny any one little act of a central  
23 bank takes time to work, but it does mean that  
24 you can superimpose upward and downward impulses  
25 and therefore have a rather better timing relationship  
26 over the system. It is like the example in one  
27 of the submissions before you of the result of  
28 a lot of stop and go driving; you put your feet  
29 on the pedal and take them off, not because you want  
30 to create jerks, but because the load is an on and





earlier than sometimes you have to keep pushing about -  
beam rates for a long time in order to have them  
I was thinking of a sentence in Lord  
Goddard's testimony where he said that in his  
in the absence of explanation of the beam rates,  
and perhaps for the policy to become effective,  
I am sure that no single figure can be substituted  
with any accuracy, but these figures do indicate  
about one of them.  
There is another point regarding  
between the two rates, but it is more or less  
in itself, and I am sure that it is not  
correct. A distinction of the two rates is  
a distinction of "one and two" which is not  
given, and it is something that is not  
and the other.  
The point I am, in the special testimony  
in his testimony to you, and I am sure  
This is not a very high rate of a beam  
beam rates, but it is not a very high rate  
and the beam rates are not a very high rate  
and the beam rates are not a very high rate  
over the years. In the line the beam rates  
of the beam rates, but the result of  
a lot of work and so nothing; you put your  
on the beam and the beam off, not because you want  
to make them, but because the beam is an on and



1 off type of thing. I think there are advantages like  
2 that in the realm of monetary policy.

3 Fiscal policy has that, but not in a  
4 discretionary way; there is the built-in flexibility  
5 of a modern fiscal system of tax setting whereby the  
6 minute business begins to drop off, even if Parliament  
7 is out of session, an expansionary mechanism goes  
8 into effect. The only trouble with built-in  
9 flexibility is that although it resists a motion  
10 in one direction it cannot be expected to reverse  
11 that motion and wipe out all of the motion; discretion-  
12 ary action could be more helpful in that regard.

13 COMMISSIONER MACKINTOSH: Would you  
14 explain that second last sentence a little further;  
15 I didn't quite get it.

16 PROFESSOR SAMUELSON: With respect to  
17 automatic stabilization?

18 COMMISSIONER MACKINTOSH: Yes?

19 PROFESSOR SAMUELSON: The powerful  
20 automatic stabilizer in our system is our heavy  
21 reliance on income tax of persons and our heavy  
22 reliance upon income tax corporations; the latter  
23 is particularly sensitive to changes in business  
24 conditions because profits are a residual item with  
25 a corporation and they are especially affected by  
26 small variations in business conditions.

27 Now, when you get a drop in business  
28 conditions, let us say a drop in the Gross National  
29 Product of a billion dollars, there would be a  
30 fractional drop in the tax receipts, but every tax



and that the United States Government is

not in a position to do so.

Please do not say that, but not in a

directionary way, in the field of flexibility

of a modern fiscal system of tax levies whereby the

income tax system is not to be kept off, even in the event

of a crisis, the Government is not to be

in a position to do so.

It is not a question of whether it is possible to

in the event of a crisis to be expected to

that the Government is not to be kept off, even in the event

of a crisis, the Government is not to be

in a position to do so.

It is not a question of whether it is possible to

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It is not a question of whether it is possible to

in the event of a crisis to be expected to





1 system which I know of only taxes a fraction of the  
2 marginal dollar. Now, that fractional change in  
3 tax receipts is in the direction which resists the  
4 movement, whether it be downward or upward, but it  
5 is always a fraction and never enough to reverse a  
6 trend and that is what I had in mind.

7 COMMISSIONER MACKINTOSH: I see.

8 PROFESSOR SAMUELSON: I want to emphasize,  
9 though, that the wisdom of the past has a half life  
10 that is quite short. When Adam Smith sat down to  
11 write down the four tenets of taxation, (which  
12 his editor said would be just four things he happened  
13 to think of that morning,) one of his tenets of  
14 taxation was that a good tax is a tax with steady  
15 revenue year in and year out, no matter what happens  
16 to the state of the economy.

17 Now, we have turned that doctrine upside  
18 down in the 20th century and regard a good tax as  
19 one with built-in flexibility and which doesn't work  
20 independently of anything but which moves with respect  
21 to anything. This is a two-edged sword but it is  
22 a powerful drag -- albeit a fractional drag -- on  
23 the upside and that is why the automatic stabilizers  
24 cut down the amplitude of a pre-existing cycle, but  
25 can't cut it out completely or reverse it.

26 COMMISSIONER MACKINTOSH: I notice that  
27 you leave out excise and sales taxes; wouldn't they  
28 operate much the same?

29 PROFESSOR SAMUELSON: The purchase tax,  
30



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1 which was a discretionary instrument in the British  
2 system, is an example of it; that would act very much  
3 in the right direction because it is not gradual.  
4 If it is across the board and not applied to luxuries,  
5 which have a very high income demand, this tax change  
6 is perhaps not as stabilizing as a graduated one,  
7 but it is stabilizing and it is an important part of  
8 the fiscal systems of our country and is perhaps  
9 important for other countries.

10 COMMISSIONER BROWN: If this applied to  
11 luxuries it would be even greater?

12 PROFESSOR SAMUELSON: Yes.

13 COMMISSIONER BROWN: This morning you  
14 distinguished between a transfer type of government  
15 expenditure and an expenditure of goods and services.

16 PROFESSOR SAMUELSON: Yes.

17 COMMISSIONER BROWN: Would you like to  
18 amplify that?

19 PROFESSOR SAMUELSON: Yes. An example  
20 of an expansion of goods and services would be the  
21 hiring of an employee of a Royal Commission, or a  
22 judge, or a postal clerk, the purchase of a typewriter  
23 for the government, or the purchase of a battle-ship;  
24 those use up the resources at the very first round.

25 An example of a transfer expenditure by  
26 the government would be the cost of a payment to a  
27 widow, independent of any activity which she now does.  
28 To her it is disposable income and on the next round  
29 she spends it and it shows up in the Gross National  
30 Product figures, but on the very first round it is a







1 transfer. There are some other transfers that are  
2 not important in this connection.

3 of the go on When I was replying to your earlier  
4 question about the potency of fiscal policy I was  
5 careful to compare the potency of taxes and  
6 government expenditure on goods and services.

7 With respect to transfer expenditures by  
8 the government, unless they happen to go to  
9 particularly spendthrift types, or to low income  
10 groups who are particularly rapid in spending their  
11 money, or unless the tax happens to come from  
12 particularly wealthy people whose expenditures are  
13 independent of their income, it is much more of a  
14 standoff. Transfer expenditures have about the  
15 same dollar for dollar potency -- and this is  
16 just an approximation -- as tax receipts.

17 COMMISSIONER BROWN: Have any of the other  
18 Commissioners any further points on this fiscal  
19 matter? Otherwise I would like to ask you for  
20 your comments on the proper goal of the Council of  
21 Economic Advisers in all this picture?

22 PROFESSOR SAMUELSON: The present Council  
23 of Economic Advisers constitutes a staff for the  
24 President -- for the executive; it is within the  
25 executive office but it is not literally within the  
26 White House. The primary allegiance of the Chairman  
27 of the Council of Economic Advisers is to the  
28 executive. He is not a disinterested scientist  
29 who is free to go and give his opinion on every  
30 subject, because his remarks wouldn't be interpreted



transfer. There are some other transfers that are not important in this connection.

When I was replying to your earlier question about the potency of fiscal policy I was careful to compare the potency of taxes and government expenditure on goods and services. With respect to transfer expenditures by

the government, unless they happen to go to particularly spendthrift types, or to low income groups who are particularly hard in spending their money, or unless the tax happens to come from particularly wealthy people whose expenditures are independent of their income, it is much more of a standoff. Transfer expenditures have about the same dollar for dollar potency -- and this is just an approximation -- as tax receipts.

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Toronto, Ontario

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1 to be those of a disinterested scientist, but  
2 would be interpreted to be that of the spokesman  
3 of the government. He is not directly responsible  
4 to Congress, but he testifies before Congress.



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to the State of a distinguished character, and  
would be interpreted to be that of the appointment  
of the Government. He is not directly responsible  
to Congress, but he testifies before Congress.

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1 I cannot remember a case recently where the  
2 chairman of the Council of Economic Advisers has  
3 said: "I refuse to answer the question of a Senator  
4 from the Joint Economic Committee because I invoke  
5 the privilege of executive privacy", but you can  
6 imagine such a case.

7 He is concerned with fiscal policy,  
8 he is concerned with monetary policy, and he meets  
9 with committees of a formal or informal sort which  
10 have various members of the Treasury, including the  
11 Secretary of the Treasury as members, and which  
12 various members of the Federal Reserve System, such  
13 as the Chairman of the Board of Governors, attend.  
14 I do not think that one can imagine a good system  
15 in which the Chairman of the Council of Economic  
16 Advisers would be in a position to tell the Secretary  
17 of the Treasury just how he ought to finance his bonds,  
18 or tell the head of the central bank exactly how he  
19 ought to conduct his open market operations; but I  
20 do think it is appropriate for economists within the  
21 government, to make their advice available to the  
22 President, who indicates his wishes to his own  
23 secretary of the treasury and exercises his good  
24 influences with the head of that Federal Reserve.

25 Going by what has been announced in the  
26 newspapers, there have been periodic meetings at  
27 the White House to which Chairman Martin of the  
28 Federal Reserve has been an attendant. In Woodrow  
29 Wilson's day I think this could not have taken place.  
30 I believe Woodrow Wilson, when the Federal Reserve





I am not sure if you have seen the  
report on the subject of the  
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1 Act was first established, went so far as not to  
2 invite to his official receptions members of the  
3 Federal Reserve Board lest there be any possible  
4 thought that the independence of the Federal  
5 Reserve was being infringed. He perhaps remembered  
6 Adam Smith's dictum, that tradesmen never get  
7 together even for the purpose of social pleasure but  
8 what they conspire together against the consumer.  
9 He did not want to break bread with the Federal  
10 Reserve Board.

11 Those days are gone. If the recommendations  
12 of the Commission on Money and Credit were to go  
13 into effect, the Chairman of the Board of Governors  
14 of the Federal Reserve would serve at the pleasure  
15 of the new president. The president would have  
16 the right to name him. No one knows what the  
17 unwritten tradition of the United States is when  
18 the new president comes in. As far as I know  
19 nobody knows. It is possible that President  
20 Franklin Roosevelt and the Chairman of the Federal  
21 Reserve Board knew what the unwritten tradition was.  
22 It is possible that Chairman Martin and President  
23 Kennedy knew in 1960, but the likes of us do not  
24 know. I cannot believe that is a perfectly  
25 satisfactory arrangement. A tradition that everybody  
26 knows is just as good as a law, but a tradition  
27 that is ambiguous and sometimes followed and  
28 sometimes not followed seems to me to have all  
29 the disadvantages that one can imagine.  
30



and was still in the same way as before.

There is no doubt that the same thing is true.

Radical Reformers have been there for many years.

There is no doubt that the same thing is true.

There is no doubt that the same thing is true.

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There is no doubt that the same thing is true.

There is no doubt that the same thing is true.





1 So to my mind the Council of Economic Advisers is  
2 just part of the economic staff of the executive.  
3 I am not particularly in favour of the grandiose  
4 proposals that have been made by several important  
5 people in the United States, that there be a grand  
6 council -- let me call it an ecumenical economic  
7 council -- involving the stocks and flows set up,  
8 to co-ordinate these various things.

9 I believe that the distinguished  
10 Elliott Bell, former adviser to candidate Dewey,  
11 the Commissioner of Banks for New York State,  
12 editor of Business Week, has proposed such a  
13 commission.

14 Just this summer the distinguished  
15 Arthur F. Burns, a professor economics and the  
16 president of an economic research committee, the  
17 chairman of President Eisenhower's Council of  
18 Economic Advisers has proposed a kind of super-  
19 authority or group to come together for the purpose  
20 of discussion. I have thought a good deal about  
21 the problem - and I do not think that this would  
22 help a great deal. In fact, it might hurt since  
23 the division of responsibility is very unclear  
24 in such a situation. You could get an awful lot  
25 of buck passing in such a situation.

26 COMMISSIONER LEMAN: Would you argue  
27 even more that there should not be such a council  
28 which would be deemed not to be government?

29 PROFESSOR SAMUELSON: I think I would  
30 go a little further. I think that an advisory



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1 council to the central bank is useful. I have in  
2 mind the board of the New York Federal Reserve Bank;  
3 the board of directors of the Boston Federal Reserve  
4 Bank. Those are esteemed citizens picked to serve  
5 on the board. The Chairman might be the president  
6 of my college. He might be the treasurer of a  
7 large oil company. This is a very nice relationship  
8 to give the central bank an insight into what is  
9 happening in the city and what is happening abroad,  
10 but these people do not decide open market operations.  
11 It would be wrong for them to do so. I think it  
12 is very wrong to depend upon committees outside the  
13 government to really call the shots on policy.  
14 At periodic intervals this is all right to focus  
15 public attention.

16 We have just had a management-labour  
17 committee in the hope of finding something better  
18 to control cost-push inflation, which involves  
19 fiscal policy and monetary policy. It has  
20 representatives of business, it has representatives  
21 of labour and it has so-called public representatives.  
22 I do not want to pre-judge the matter, but it is my  
23 general impression that people have not found it  
24 to be a terribly important operation. It certainly  
25 has not done a lot for the price-wage cost-push  
26 part of the problem. Some economists interested  
27 in wages think that if that group were more active  
28 it would do more harm than good. So, I do not  
29 think that the Council of Economic Advisers should  
30 be given part of the responsibility for these acts.





Bar: These two cut most of the same phloem to serve



1 I do not want to speak of the London  
2 situation, but the submission before you which I  
3 read suggested that it is extremely valuable to  
4 have exactly the same composition for the Bank  
5 of England as is now the case. I feel that England  
6 must be a pretty lucky country to be just right  
7 now, so that any change from its current position  
8 would be a move toward the worse.

9 I think that the primary responsibility  
10 for central banking operations must lie with the  
11 central bank with responsibility to the government  
12 after a suitable delay period and without having  
13 government breathing down the neck of the central  
14 bank in its day-to-day operations.

15 In the case of the United States the  
16 issue debated in the past has been about the  
17 relationship of the Federal Reserve to the executive.  
18 No federal reserve official known to me has ever  
19 argued that he did not owe complete and ultimate  
20 allegiance to Congress, so there is no independent  
21 Federal Reserve in my country as against legislature  
22 and the courts and the executive. There is no  
23 fourth estate of government, which is the central  
24 bank, and I think properly there should not be such.  
25 I think there have been times in certain Continental  
26 countries where the central bank has in fact been  
27 in power, and even has affected cabinet turnovers  
28 by its various foreign exchange operations. I think  
29 that is an anomaly in a democracy.

30 COMMISSIONER BROWN: Earlier this morning



I am very glad to hear of your success.





1 you discussed debt management to some degree, and  
2 I think you were quite fair in saying that you  
3 considered it as part of monetary policy. Would  
4 you care to tie this in with the other point you  
5 were discussing this morning, and that is the  
6 question of liquidity and the extent to which,  
7 by varying the maturity spectrum of existing debt,  
8 liquidity is changed?

9 PROFESSOR SAMUELSON: I think the  
10 distribution of the debt by maturity will have in  
11 the long-run a substantial effect upon the  
12 distribution of short-term and long-term interest  
13 rates. The presumption is that a long-term debt  
14 instrument which has a long time to go is essentially  
15 a less liquid instrument than a short-term one.  
16 It is less liquid to the system as a whole, and in  
17 a degree it is less liquid to the single small bank,  
18 because you cannot predict the price you will be  
19 able to realize on it. There is a risk in  
20 connection with it. I think long-term government  
21 debt is much more a rival to long-term rates that  
22 are applicable to private investment. I think, for  
23 example, the bill rate can fluctuate through a  
24 far wider range without affecting mortgage  
25 availability than can long-term government bonds.  
26 The long-term corporate bond issues are much more  
27 closely geared in price to the long-term yield on  
28 U.S. government issues than they are to the bill  
29 rate. I do not think you can have just any curve  
30 in interest yields in terms of short and long which



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1 you want. Certainly if you will the need you must  
2 will the means, and you must also take massive  
3 changes in the amount of market long-term issues.  
4 I am not making the suggestion that with a small  
5 departure from bills only you will get a tremendous  
6 advantage. With a small departure from bills only  
7 you will get a small advantage. I suspect in the  
8 long run it is not a negligibly small advantage.

9 There is a slight problem in the  
10 United States as to whether in the construction  
11 field certain of the instrumentalities set up by  
12 the government are not acting a little bit like a  
13 second central bank. I have in mind the borrowing  
14 organizations of the Federal Savings and Loan  
15 Association, which lends money; it makes money  
16 available to its members in much the same way that  
17 discounting makes money available to ordinary  
18 commercial banks. Now, I think that should be  
19 co-ordinated. There should not be two independent  
20 wills in the system involving possible conflicts,  
21 one undoing the work of the other. It seems to me  
22 that by consolidating these two into what we call  
23 a central bank, the combined operations will have  
24 an effect on the liquidity relevant to the housing  
25 area much more powerful than just a change in the  
26 short-term bill rate. The same is true with  
27 respect to the international competition for funds.

28 It was mentioned to me as we were  
29 breaking up for lunch that a change in the reserve  
30 rate against savings deposits or time deposits had







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Toronto, Ontario

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1 been announced just this morning in the United States.  
2 I do not know if this is a correct fact, but let us  
3 suppose that it is and that it was reduced from  
4 5 per cent to 4 per cent on the supposition that the  
5 Federal Reserve wants at this time to ease money  
6 a little. I hope that is what they want because  
7 all the business indicators are in a somewhat  
8 apprehensive state. This seems to me to have been  
9 a very good thing to have done, for the good it  
10 does to the domestic investment. It will probably  
11 cause less leakage of funds abroad than a similar  
12 release of millions of dollars in an area that  
13 involves the big wholesale banks in New York. Their  
14 customers must properly always look to the London  
15 bill rate in comparison with the American bill rate  
16 and shift when there is a differential. This is  
17 not what I call hot money. I think it is better  
18 called cool money. It moves with respect to the  
19 differentials.

20 It seems to me that the savings banks  
21 which are affected by this particular change, are  
22 the most likely not to be in the market; or again,  
23 commercial banks with large savings deposits such  
24 as the small banks in the part of the country that  
25 I know best, will not send money abroad and we can  
26 have more expansion with less danger to the  
27 balance of payments. This is precisely the kind  
28 of liquid operation that the good part of the  
29 Radcliffe Committee was aiming at -- which would  
30 be thrown away by the very narrow conception of a



I do not know if this is a correct fact, but let us

assume that it is and let us see what we can do.

I am sure that a part of the responsibility for the

present situation is due to the fact that the

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1 central bank -- as this is affecting the neutral  
2 money at the shortest end, regarding it as the province  
3 of the free market to adjust the differentials.  
4 Most of the differentials can be adjusted by the  
5 free market, and ought to be, but I think it can  
6 use a little help within the framework of law  
7 and responsible government for the purpose of  
8 stabilization and long-term economic development.

9 COMMISSIONER BROWN: In your brief  
10 you made it quite clear that in your opinion the  
11 treasury when selling a bond issue had to in fact  
12 disregard its cost as an element in its decision,  
13 and that its decision should be made based on  
14 monetary effects with the whole ----

15 PROFESSOR SAMUELSON: Excuse me,  
16 I hope I did not say "disregard its cost". It  
17 ought to count the cost and then incur it ---

18 COMMISSIONER BROWN: I am sorry.

19 PROFESSOR SAMUELSON: Not and consider  
20 that this was no objective at all. It should  
21 balance that cost against the advantage.

22 COMMISSIONER BROWN: Yes. I rather  
23 gathered that this should be subservient to the  
24 main objective, monetary policy as a whole?

25 PROFESSOR SAMUELSON: Yes. If I were  
26 to make a charter for debt management I would  
27 specifically say that ideal debt management is not  
28 that which over the business cycle minimizes the  
29 cost of debt services.  
30





1 The ideal debt management is one which achieves the  
2 greatest stabilization over the cycle and the best  
3 long run development at the same cost in terms of  
4 debt service costs.

5 In the United States there is an illusion  
6 on the part of some people that the secretary of  
7 the Treasury determines expenditure. I do not know  
8 how that idea could have grown up even in the  
9 sense of policing expenditure. In the United States  
10 it is the Bureau of the Budget and the Director of  
11 the Bureau; but his job is not to cut down on the  
12 armed services, say, but to co-ordinate the will  
13 of the government. The job of good government is  
14 not to cut down on government expenditure but to  
15 have the right amount of expenditure. The same with  
16 respect to debt services. Like any other expenditure  
17 it should be incurred in a good cause, and one good  
18 cause is to have the proper maturity structure of the  
19 debt, as part of good stock management for the  
20 purpose of business cycle and development control.

21 COMMISSIONER BROWN: This means that  
22 at times he will be selling at the peak of interest  
23 rates?

24 PROFESSOR SAMUELSON: Yes, that is right.

25 COMMISSIONER BROWN: And at other times  
26 he will be selling at the bottom of interest rates?

27 PROFESSOR SAMUELSON: That is right.

28 And it probably means that the proper time to  
29 lengthen the debt is when it will cost the most  
30 money.





the first of these movements is the one which is  
the most important, and the one which is the most  
important of all.

the second of these movements is the one which is  
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1 I want to express my disagreement with  
2 the position of the Joint Economic Committee  
3 Majority Report on this subject, which said that  
4 there is no particular potency in debt distribution  
5 anyway, so a good time to lengthen the debt is  
6 during a sloppy recession market when interest rates  
7 are very low, and it can be done most advantageously.

8 My view is the reverse.

9 COMMISSIONER BROWN: This is no long-  
10 term problem for him or even a short-term problem.  
11 He is selling the most expensive debt for the longest  
12 period of time?

13 PROFESSOR SAMUELSON: I think that is  
14 a desirable thing to do. If one took seriously the  
15 notion that the best debt maturity is that which  
16 minimizes the service cost to the government, then  
17 you ought to issue greenbacks, not interest-bearing  
18 money. I may say that the printing of greenbacks  
19 which is the privilege we give to the central bank  
20 -- most modern governments do not choose to use it  
21 itself; they have a go-between which does it --  
22 can sometimes be the correct thing to do. But  
23 you want to do it only when what the economy needs  
24 for stabilization of long term development purposes  
25 is a larger amount of M in the sense of cash, as  
26 against near M in the sense of bills, or as against  
27 slightly further M in terms of long-term bonds.

28 COMMISSIONER BROWN: Does the same  
29 principle hold that when interest rates are at  
30 their lowest you should sell the shortest? This



It was the purpose of the investigation to

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1 obviously creates embarrassment to him when he is  
2 next on the market.

3 PROFESSOR SAMUELSON: It would often be  
4 the advice I would give, but for the reason that  
5 when interest rates are lowest, is typically  
6 the time when the economy has a vast amount of  
7 unused resources and you want the greatest expansion  
8 effect from your stock operation or monetary policy,  
9 and you get that by short term.

10 COMMISSIONER BROWN: And by increasing  
11 the liquidity?

12 PROFESSOR SAMUELSON: Yes. But I do not  
13 subscribe to a view which is popular amongst some  
14 continental writers and bankers, particularly the  
15 older ones, that floating debt itself is about as  
16 evil as greenbacks. It is funny that people who  
17 deal with money most sometimes have the view that  
18 it is the worst thing in the world for there to be.  
19 I think that a large amount of floating debt is a  
20 normal accompaniment of a modern system like the  
21 United States, in recession times, in excessive  
22 boom times, and also in conditions of prosperity,  
23 with more or less stable prices.

24 May I make it clear that I am interested  
25 in reducing debt service charges, all other things  
26 being equal, as part of good management. One of  
27 the ways to reduce debt service charges is by properly  
28 catering to the desires of the market. This does not  
29 mean that the market place tells you what you ought  
30 to do, but if insurance companies have a great need



UNITED STATES DEPARTMENT OF THE INTERIOR

BUREAU OF LAND MANAGEMENT

WASHINGTON, D. C. 20250

THE ADVISOR I WOULD LIKE TO SEE THE REPORT THAT

WHEN I GET THE REPORT AND I WOULD BE GLAD TO

THE TIME WHEN THE REPORT WAS A VERY GOOD ONE

THAT I RECEIVED AND YOU WOULD NOT BE GLAD TO

THAT I RECEIVED FROM YOUR OFFICE OF THE BUREAU OF

AND YOU WOULD NOT BE GLAD TO

COMMISSIONER OF THE BUREAU OF LAND MANAGEMENT

THE BUREAU OF LAND MANAGEMENT

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1 for a bond which would not be callable for ten years,  
2 and they are willing to pay for the privilege of  
3 playing safe for ten years from now, then the astute  
4 secretary of the Treasury will issue the type of  
5 security which creates the greatest good all round.  
6 That is making them pay for the privilege. So that  
7 there should be no unnecessary enlargement of debt  
8 service, because debt service, although a necessary  
9 evil, is an evil.

10 I do not like in the American system to  
11 have to raise \$10 million fixed taxes every year  
12 for this purpose. But we do live under law and  
13 order, and people who bought the bonds bought them  
14 in good faith. I am not in favour of a capital  
15 levy or an expropriation of them, and I think it  
16 is very well worth the price that we have to pay.

17 COMMISSIONER BROWN: That is all I had  
18 on that.

19 COMMISSIONER MACKINTOSH: Professor  
20 Samuelson, I should like to direct your attention  
21 for a little while to the international side. We  
22 are accustomed here to think that we have a very  
23 open, not<sup>to</sup>/say windy, economy, and putting aside  
24 the question of degree, how far in such an economy  
25 do you think you can find any criterion for  
26 monetary policy other than your international bonds  
27 and your international flows? In other words, how  
28 significant is a domestic monetary policy aside  
29 from the external?

30 PROFESSOR SAMUELSON: Leaving out the







1 problem of objectives and sticking to the problem  
2 of the factual choice open to you, the smaller you  
3 are, the more open an economy you have, the less scope  
4 you have for an independent policy. This would be  
5 obvious if you thought of a province of Canada which  
6 tried to have central banking operations and who  
7 set the rate of interest it wanted. I do not  
8 suppose that any bank in Canada would be foolish  
9 enough to believe that.

10 COMMISSIONER MACKINTOSH: You might  
11 be surprised!

12 PROFESSOR SAMUELSON: Well, you would  
13 find a leakage abroad very rapidly, and I think the  
14 testimony given before you by Professor Lundberg of  
15 Sweden, and by Dr. Holtrop of the Netherlands Bank  
16 is very relevant in this connection. On the other  
17 hand, I think you have a measure of autonomy, and  
18 it is within that measure that you would work.  
19 Furthermore, this has a bearing upon what the rules  
20 of the game are. (1) Do you operate within the  
21 framework of a fixed exchange rate standard?  
22 (2) What is the situation with respect to your  
23 capital market?

24 Now, I have read with great interest  
25 Professor Lundberg's discussion of the Swedish  
26 situation. He pointed out in a very matter of  
27 fact way, because it is one of the facts of life  
28 which he has always known, that there has been  
29 almost no capital investment into Sweden. I had  
30 not realized that until last May when I was lecturing







Nethercut & Young  
Toronto, Ontario

- 6338 -

1 in Stockholm. I learned it with great surprise.  
2 I also learned what he did not mention, -- but  
3 perhaps it came out during his oral testimony --  
4 that it was because the Swedes do not allow capital  
5 investment. Standard Oil of New Jersey cannot go  
6 into Sweden and buy up an existing network of filling  
7 stations. It can do that in Belgium. It can do  
8 that in France. It can do that in the U.K. But  
9 it cannot do that in Sweden. When I was in Sweden,  
10 with great generosity the government permitted a  
11 large canning operation to merge with a Norwegian  
12 canning operation, probably because they were nice  
13 Scandinavian Norwegians and this was permitted.  
14 I think that that is one of the reasons which  
15 would explain Lundberg's problem. He said: How is it  
16 that our federal government has not been able to  
17 contrive a balance of payments crisis in the post  
18 war period since 1947, and we are the most open  
19 economy imaginable because we have low tariffs?  
20 I think if you had Swedish provinces and they went  
21 to a nearby market to borrow at their discretion,  
22 there might have been a different situation there.  
23 Particularly for a country like Canada, living --  
24 I will not say in the shadow of the United States,  
25 -- in close proximity to the United States, you  
26 have to specify to me just exactly what will be the  
27 freedom of different people to borrow, and what  
28 would be their habits. That being the case, you  
29 will find a lot of credit policy is determined  
30 not by the federal treasury but by some of your



OFFICE OF THE  
ATTORNEY GENERAL

WASHINGTON, D. C.

MEMORANDUM FOR THE ATTORNEY GENERAL

RE: [Illegible]

1. [Illegible]

2. [Illegible]

3. [Illegible]

4. [Illegible]

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13. [Illegible]

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16. [Illegible]

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18. [Illegible]

19. [Illegible]

20. [Illegible]

21. [Illegible]

22. [Illegible]

23. [Illegible]

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25. [Illegible]

26. [Illegible]

27. [Illegible]

28. [Illegible]



Nethercut & Young

Toronto, Ontario

- 6339 -

1 provincial treasuries, and by some of your very  
2 large corporations. There is a discipline imposed  
3 by the international balance of payments problem  
4 for every country. The only exception I know is  
5 the United States. From 1933 until about 1958,  
6 the United States -- and I went to every meeting  
7 in Washington and I have read the record every day  
8 -- had no great concern about a balance of payments  
9 problem except to help the other fellow. It was  
10 a honeymoon which lasted much longer than most  
11 honeymoons are expected to last, but now it is  
12 over. We have rejoined the human race and we too  
13 have a balance of payments problem. As Per Jacobsson  
14 said, Providence did not give the United States  
15 permanently an immunity from these various problems.

16 I think that if I were a small nation  
17 and I were somewhat dependent upon staple products  
18 like forestry, uranium, and various mining products,  
19 and I had open to me the option -- which is not open  
20 in the United States -- of a floating exchange rate,  
21 I might take up that option. I do not think the  
22 United States is in a position to let its exchange  
23 rate float because the rest of the world would not  
24 let it happen. A small country might be in the  
25 position where the rest of the world would let it  
26 happen, and I think that certain advantages and a  
27 certain increased freedom could come to monetary  
28 policy in such a regime. If the freedom is the  
29 freedom which is going to be abused and the freedom  
30 which will not make corrections in the economy







1 which ought to be made, and there is no discipline  
2 or substitute for the discipline of the balance of  
3 payments, then this is probably going to do more  
4 harm than good. Possibly under better management a  
5 flexible foreign exchange rate policy, including  
6 perhaps a floating rate, gives extra options to the  
7 authorities, both for fiscal policy and for monetary  
8 policy.

9 COMMISSIONER MACKINTOSH: If your  
10 floating exchange rate does protect you and fluctuates  
11 a great deal, are not the penalties fairly heavy?  
12 If you have a floating exchange rate which stays  
13 pretty steady, then that is all right.

14 PROFESSOR SAMUELSON: If you have a  
15 floating exchange rate and you have in your money  
16 market very panicky individuals who seem to be  
17 especially prone to listen to every possible rumour,  
18 and some sharp operators jump on every movement so  
19 that the speculation which you get tends to be  
20 not of an informed stabilizing pattern but instead  
21 glorifies in accentuating movements, something  
22 alleged to be true of some of your small mining  
23 stocks -- I now mean equities -- then you could,  
24 I think, get almost none of the advantages from a  
25 floating exchange rate and you would reap the  
26 maximum disadvantage. It would be hard to carry  
27 on foreign trade. Every exporter and importer  
28 would have to be an arbitrage expert. The premium  
29 which would have to be paid for coverage to Loyds,  
30 or anybody else, would be very high under those





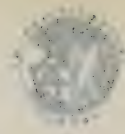


1 circumstances, and it would be a dead weight drag  
2 on international trade.

3 Moreover, this could be true of any  
4 speculative market because of an extra feature with  
5 respect to foreign exchange rates of a country.  
6 When I speculate in wheat and I pass rumours around  
7 which will make the price of wheat temporarily go  
8 up, there is an underlying economic law which says  
9 that there is only so much physical wheat and only  
10 so much need for wheat, and the boom will come down  
11 and will have as its rendezvous some rough economic  
12 approximation to the equilibrium level.

13 In the foreign exchange rate field we  
14 cannot be sure of that, for the reason that if you  
15 have a very strong bear raid on a currency you  
16 might find within the country monetary policies  
17 and fiscal policies which accompany that which  
18 justify the exchange rates being low permanently.  
19 In other words, there is no par to which things  
20 return. That means that a bear raid, a speculation,  
21 may be successful when it is being destabilizing;  
22 whereas in penny Canadian stocks and in the wheat  
23 market, on the whole the people who end up making  
24 money, unless there is misinformation being spread,  
25 are the people who correctly gauge the depths of  
26 the mines, the value of copper ore, and the demand  
27 for wheat in comparison with the weather in the  
28 wheat growing provinces.

29 In the exchange rate field where there  
30 is no par, because of the grain of truth in the



Moreover, this could be true of any speculative market because of an extra feature with respect to foreign exchange rates of a country. When I speculate in wheat and I pass rumours around which will make the price of wheat temporarily go up, there is an underlying economic law which says that there is only so much physical wheat and only so much need for wheat, and the boom will come down and will have as its rendezvous some rough economic approximation to the equilibrium level.

In the foreign exchange rate field we cannot be sure of that, for the reason that if you have a very strong bear raid on a currency you might find within the country monetary policies and fiscal policies which accompany that which justify the exchange rates being low permanently. In other words, there is no bar to which things return. That means that a bear raid, a speculation, may be successful when it is being destabilizing; whereas in penny Canadian stocks and in the wheat market, on the whole the people who end up making money, unless there is misinformation being spread, are the people who correctly gauge the depths of the mines, the value of copper ore, and the demand for wheat in comparison with the weather in the

In the exchange rate field where there is no bar, because of the grain of truth in the



1 Quantity Theory of money that we would be no worse  
2 off if we had twice as many dollars and twice as high  
3 prices, the people who destabilize exchange rates  
4 might be in the end rewarded. This is an aspect  
5 of the problem which is on the negative balance  
6 sheet with respect to floating exchange rates.

7           The last thing in the world that I  
8 want to do is to appear in Canada before experts  
9 who know something about Canadian affairs and  
10 pontificate about them. But I should have thought  
11 that when the Canadian dollar was \$1.03 in terms  
12 of the American dollar and the Canadian economy  
13 was slowing up in its rate of growth, not compared  
14 with the American economy but in terms of its per  
15 capita rate of growth -- because of lots of  
16 external factors, such as the fact that the  
17 uranium market was finally giving out, and a number  
18 of natural reasons like that -- that would have been  
19 in order in those circumstances would not be a forced  
20 devaluation of the Canadian dollar from \$1.05 to \$1.03  
21 and then to \$0.99 by some kind of exchange stabil-  
22 ization activity, but rather that the floating rate  
23 would have given the central bank the freedom to  
24 pursue a more expansionary policy than would have  
25 been possible under a fixed exchange rate.

26           In that circumstance, as the Canadian  
27 economy expanded and its imports expanded relative  
28 to its exports, the \$1.03, without regard to any  
29 speculation or nudge by the government directly,  
30 would have flowed downward from \$1.03 to \$1.01,







1 and even down to \$0.98, and stayed at \$0.98. That  
2 would be, to my mind, using the advantage of a  
3 floating exchange rate. I do not know whether in  
4 any period of history it has ever worked out like  
5 that, or could be expected to work out like that.  
6 I would hope that in the future it could be expected  
7 to work out.

8 I might call your attention to one  
9 possibility other than a floating exchange rate,  
10 freely floating. Professor Phillips, whom I  
11 mentioned earlier and who happens to be a visiting  
12 professor at M.I.T. from the London School of  
13 Economics just for this year, is a very able  
14 economist and also a very clever man at thinking  
15 up gadgets. Most people's gadgets in economics I  
16 do not like, but he has mentioned one possibility  
17 here which sounds interesting to me. He said to  
18 me: "Why should not some governments, particularly  
19 small governments, have a policy that they will  
20 permit an exchange rate fluctuation within any one  
21 year of a certain magnitude? Let us say it is one  
22 per cent a year. One per cent per year is unlikely  
23 to stampede speculators, because you cannot make  
24 much out of it; but over a ten year period, if  
25 your cost level is getting a little out of line with  
26 other people, it will help you make adjustments."  
27 Now, if you do this, and on the first day of the  
28 year you use up your one per cent, then you are right  
29 back in the problem. Again, it is a one-way move  
30 for speculators. You guess that you are going to be







1 forced through. But if you are a little more subtle  
2 than that -- and, by the way, one per cent is not  
3 big enough; it depends on the nature of your export  
4 industries, I would think, and your capital markets  
5 -- I think it would give you many of the advantages  
6 of stability for international trade purposes, and  
7 some of the advantages over a long period of time  
8 of adjustment which can come from differential  
9 exchange rates. I do not recommend this to this  
10 Royal Commission, but I do nominate it for  
11 consideration along with lots of other possible  
12 devices.

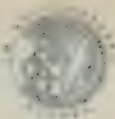
13 ~~that a~~ COMMISSIONER MACKINTOSH: I take it  
14 that the central purpose of that is to avoid the  
15 disruption of this demonstration of a fundamental  
16 disequilibrium to the international monetary fund  
17 and a change of par values?

18 PROFESSOR SAMUELSON: Yes.

19 ~~case, if we~~ COMMISSIONER MACKINTOSH: It is a  
20 sort of instalment plan?

21 ~~circumstances~~ PROFESSOR SAMUELSON: Yes. It is not  
22 as if we really stick to the old rules of the gold  
23 standard and have internal flexibility of wages  
24 going up and down. What happens is that in effect  
25 we insist on rigid wage rates.

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1 COMMISSIONER GIBSON: May I interject  
2 a question at this point?

3 THE CHAIRMAN: Yes, certainly.

4 COMMISSIONER GIBSON: Professor Samuelson,  
5 you gave a very interesting hypothetical question  
6 on the Canadian situation. You deliberately said  
7 it was hypothetical. Supposing we had an exchange  
8 rate of \$1.03. This would give you an opportunity  
9 to pursue a monetary policy of a more expansionary  
10 nature. You would be free to do this.

11 PROFESSOR SAMUELSON: Yes.

12 COMMISSIONER GIBSON: If you add to  
13 that a country running very large balance of payment  
14 deficits, which I think would be generally recognized  
15 as being an undesirable picture, would that change  
16 your conclusions very much or would it change them  
17 at all?

18 PROFESSOR SAMUELSON: I think in that  
19 case, if you have the freedom to have a floating  
20 exchange, it would seem to me that under that  
21 circumstance, if there was a permanent deficit in  
22 the balance of payments that looked as if it were  
23 due not to temporary reasons-- in other words, in  
24 Australia if the wool crop in one particular year  
25 is bad there are great strains imposed on the  
26 balance of payments, and the central bank will help  
27 them right through -- say, if you felt that the cost  
28 structure of a country like Canada was getting out  
29 of the line and was not likely to get into line soon,  
30 then I would certainly think that would be the best





CONFIDENTIAL - SECURITY INFORMATION

TO: DIRECTOR, FBI

FROM: SAC, NEW YORK

SUBJECT: [Illegible]

Re New York letter to Bureau dated 1/15/64, captioned as above. The information received from the source is that the individual named in the letter is a member of the [illegible] and is active in the [illegible] of the [illegible]. This individual is also a member of the [illegible] and is active in the [illegible] of the [illegible]. The source has provided the following information regarding the individual named in the letter:

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

[Illegible]

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[Illegible]

[Illegible]

[Illegible]

[Illegible]



1 occasion for not, by austerity at home, preserving  
2 the \$1.03 exchange rate through a tight monetary  
3 policy. Nor would I even think it a very good thing  
4 to bridge the gap by borrowing abroad, as you can  
5 do if you generate high interest rates at home.  
6 That short-term relief puts off the day of adjustment.  
7 I am not wholly facetious when I say that I think  
8 all this is hypothetical; perhaps I make reference  
9 to a country like Aleutia, or some other textbook  
10 name, because I don't know enough about the Canadian  
11 situation of a few years ago, although some people  
12 would think my analysis just fits to state with  
13 confidence that what I am saying is applicable to  
14 Canada as against some other view. I would have a  
15 suspicion, though, that there may have been that  
16 opportunity.

17 COMMISSIONER GIBSON: We also had a  
18 persistent and very large balance of payments  
19 deficit.

20 PROFESSOR SAMUELSON: Yes. In response  
21 to a question by Dr. Mackintosh who asked me, I  
22 think, if you found you had a very obstreperous  
23 market of speculators and not only a windy economy  
24 but windy speculators who got their wind up very  
25 easily and reacted upon each other -- let me say  
26 that if I had a floating exchange rate I would put  
27 a good deal of weight upon a stabilization board  
28 in the country which would counteract that situation  
29 and would even teach the rascals a lesson  
30 occasionally in a way very painful to them.







1                   You cannot do that if you have nothing  
2                   in your coffers. You have to start out with enough  
3                   foreign exchange to be able to operate, for sometimes  
4                   when you try to punish them it is going to take a  
5                   good, hard campaign to do it. You better be sure  
6                   you are loaded for that. There is no reason why,  
7                   if you have a floating exchange rate, you cannot  
8                   insist that it float very gently, for then you are  
9                   just back to where you were with a stable exchange  
10                  rate. A stable exchange rate is a floating exchange  
11                  rate that is not allowed to float at all or only  
12                  allowed to float between very narrow gold points.

13                 Many people have suggested there be a  
14                 widening, if necessary an artificial widening, within  
15                 the gold points in which exchange rates fluctuate.  
16                 I believe that in one of his incarnations Mr. Keynes  
17                 in the 20's suggested that. I do think that people  
18                 are a little optimistic to believe a slight widening  
19                 of the exchange rates will handle a fundamental  
20                 disequilibrium. If you have a real disequilibrium,  
21                 you can't have very much confidence that you  
22                 letting the British pound fluctuate from \$2.90  
23                 to \$2.70 as against \$2.82 to \$2.78 will cure it;  
24                 but it is quite good for short-term seasonal  
25                 fluctuations and other things like that.

26                 COMMISSIONER MACKINTOSH: I do not  
27                 want to examine this in great detail but what is  
28                 your view on the adequacy of international liquidity  
29                 in these days of various proposals for enlarging  
30                 immediately or ultimately?



CONFIDENTIAL

Page 2

The Agency is not in any better position

to give answers to the questions which have been asked.

There is no doubt that the Agency is in a position to

provide information to the public in a timely and

accurate manner. The Agency is not in a position to

provide information to the public in a timely and

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1 PROFESSOR SAMUELSON: If the principal  
2 nations of the world could get together with the  
3 International Monetary Fund after a good deal of  
4 private consultation of government officials and  
5 central bank officials, and set up a more formal  
6 arrangement involving a larger amount of reserves,  
7 I think that would be a very good thing. That  
8 does not mean I agree with the Triffin Plan or any  
9 particular type of plan, but I think it would be a  
10 good thing not merely because the quantum of real  
11 world trade is growing very fast compared to the  
12 quantum of money that our present gold mining and  
13 instruments provide, but because the countries of  
14 the world and their balances of payments in the  
15 world, it seems to me, are out of kilter somewhat  
16 in respect to each other, and larger reserves would  
17 be very helpful in easing the situation.

18 There may be a day ahead when that  
19 quantum of world goods becomes so much greater  
20 than the amount of the gold increase that you will  
21 have to have very high stilts on the gold, and if  
22 you do not do it in a formal arrangement you will  
23 have stilts that wobble and are not quite long  
24 enough, and there will therefore be a drag upon  
25 world trade. I do not think we are yet in that  
26 particular position, and so it is not for that  
27 reason at the moment I would be most in favour of  
28 such an expansion. But I am in favour of expansion,  
29 and one of the by-products of that would be good.  
30 It would be a bad thing, however, if it just resulted





17

THE HISTORY OF THE UNITED STATES

CHAPTER I  
THE DISCOVERY OF AMERICA  
The first discovery of America was made by Christopher Columbus in 1492. He was an Italian explorer who sailed across the Atlantic Ocean in search of a new route to the East Indies. On October 12, 1492, he landed on the island of San Salvador in the Bahamas. This was the first of many voyages that Columbus made to the Americas. He discovered that the Americas were a new world, and he brought back to Europe many new plants and animals. Columbus's discovery of America led to the colonization of the Americas by European powers. The Americas became a source of wealth for Europe, and they played a major role in the development of the Western world.



1 in thoughtless finance.

2 COMMISSIONER MACKINTOSH: In what?

3 PROFESSOR SAMUELSON: Thoughtless  
4 finance and just used as an occasion to give  
5 irresponsible government more rope to create  
6 internal demand pull inflation. I do not think  
7 demand pull inflation has been a problem in the  
8 United States, and I suspect it has not been a  
9 primary problem in Canada. But there are other  
10 parts of the world where the diagnosis might well  
11 be different.

12 COMMISSIONER MACKINTOSH: It certainly  
13 has not been here recently.

14 PROFESSOR SAMUELSON: No, it has not  
15 been recently, but it is possible that what is  
16 going on in Continental Europe where money wages  
17 in, say, Germany are rising more than 10 per cent  
18 a year and productivity is rising but not by  
19 anywhere near that amount, is accompanied by some  
20 elements of demand pull. I do not want to wish  
21 inflation on my neighbours but if they persist in  
22 it for a little while, I guess we will be able to  
23 tolerate it!

24 COMMISSIONER MACKINTOSH: The same  
25 argument can be made that a little inflation in  
26 the United States might ease our position.

27 COMMISSIONER LEMAN: Mr. Chairman, there  
28 is one very short question I should like to ask  
29 Professor Samuelson. It refers to the last  
30 sentence of your Section 12 on page 28. You have







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1 explained that central banks started as being  
2 really super-commercial banks with a priority  
3 of privileges over others and gradually they  
4 really became public institutions. In the last  
5 sentence, though, you write:

6 "Profit maximizing is at least  
7 a definite task and its disappearance  
8 makes the job of decision-making all  
9 the more ambiguous and difficult."

10 Is there a little nostalgia in there?

11 PROFESSOR SAMUELSON: No, I just had  
12 in mind that I would rather run a sweat shop or a  
13 department store than the Ford Foundation, just  
14 from my own personal decision-making ease, because  
15 each day you would come back from the sweat shop  
16 or department store and you would say, "Another  
17 day, another dollar". In deciding whether to stock  
18 certain merchandise you would ask yourself the  
19 question, "Will it pay?" That is a crispness which  
20 is very helpful for decision-making, but if you are  
21 running the Ford Foundation you are giving away  
22 money, and the most difficult thing in the world  
23 is to score yourself on whether you are giving away  
24 the money well. The business of the central bank  
25 is not to give away money but it is to achieve the  
26 common good in the macro-economic field, and there  
27 is no cash register which shows you every day just  
28 how you are doing. That is all I had in mind there.  
29 It would be terrible if the central bank went back  
30 to its primary concern in terms of making money,



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1 for money will not manage itself.

2 COMMISSIONER LEMAN: May I ask you this  
3 other question. I am not referring now to times  
4 when you must be careful. For instance, you  
5 mentioned the present balance of payments position  
6 of the United States which forces that country to  
7 adjust itself to certain difficulties.

8 PROFESSOR SAMUELSON: Yes.

9 COMMISSIONER LEMAN: But in general  
10 would you say that governments have been a little  
11 timid about trying things in this field?

12 PROFESSOR SAMUELSON: Do you mean trying  
13 for new instrumentality and gadgets?

14 COMMISSIONER LEMAN: Testing techniques  
15 by going a little further than they felt they should  
16 go but just to get more information about the workings  
17 of the various techniques used?

18 PROFESSOR SAMUELSON: I have a slight  
19 feeling in that direction. I am very happy that the  
20 present Under-Secretary of the Treasury, Robert Roosa,  
21 is trying out a whole set of new things. He is  
22 even having the government issue underwritten by  
23 private investment banking firms the way an issue  
24 by a large company would be underwritten. I do not  
25 think we have the last word in this respect. I have  
26 endeavoured in my submission to you not to humour  
27 my desire for new experience. However, I would  
28 like the experiment in which you let the discount  
29 rate move with the bill rate, because I might learn  
30 something as an economist from it. It is the same





For money will not be given in any

circumstances. I am not returning now to these

other points. I am not returning now to these

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1 feeling I have when M.I.T. builds a building,  
2 particularly if it is not an economics building.  
3 I would like to have them get a good architect and  
4 take some risks; for the whole world learns from  
5 new kinds of architecture and it is but a part of  
6 our burden not to build something just like what  
7 everybody else builds. But I have tried to be a  
8 responsible witness here and not have Canada's well-  
9 being sacrificed to my thirst for knowledge; but  
10 I must confess at the subconscious level I do have  
11 that feeling because I do not think we have found  
12 that the pioneering is over in the field of  
13 finance.

14 I can illustrate that by a number of  
15 cases. For instance, there is Governor Strong's  
16 stumbling on open-market operations. People did  
17 not really know about them or understand them.  
18 That was a very good find. Or let us take a  
19 bankrupt railroad in the United States -- and there  
20 are too many of them. They could get diesel engines  
21 at about 5 or 6 per cent even when their credit was  
22 worthless, and this was because somebody thought  
23 up equipment certificates: you could use the  
24 diesel engine, which was transferable as a chattel  
25 mortgage, and transfer it. Now, that did more for  
26 railroad financing, for dieselization, than any  
27 conventional central bank. I congratulate Chairman  
28 Martin and Secretary Dillon and Under-Secretary  
29 Roosa that the American government has been quite  
30 daring with respect to changing interest ceilings



take some risks; for the world needs them





1 on time deposits.

2 Many of the special interest groups in  
3 housing were very concerned that if you let savings  
4 banks pay higher rates of interest, this would  
5 choke off credit and would be part of a hard credit  
6 policy. However, it actually makes more credit  
7 available than would otherwise be the case;  
8 but it did involve risk and experimentation. It is  
9 a risk that has paid off. The departure from bills  
10 only by Operation Nudge did not do as much for  
11 residential housing financing as the act of changing  
12 the interest ceilings for time deposits did;  
13 but it has been good for residential financing in  
14 this rather weak recovery period when we have  
15 needed help in the residential construction  
16 picture. Therefore, I must say that I do think  
17 that a little trial and error and experimentation  
18 is in order.

19 COMMISSIONER LEMAN: Are there people  
20 in the United States who feel that a tax reduction  
21 at this time would be a very dangerous thing and  
22 could do great harm?

23 PROFESSOR SAMUELSON: There are a  
24 number of people who think that. A number of them  
25 say they do not believe it, but there are other  
26 people in Zurich who do believe it. I know from  
27 talking with Continental bankers that they  
28 sometimes experience some embarrassment in New  
29 York and Boston because their genial hosts say to  
30 them, "You are very worried about or deficit



insisting in terms of our balance of payments  
should you? And they are sometimes inclined to

say, "No, we are not worried." But it is

theoretical of a great deal to worry when this

point is obviously about him to be worried. That

is not a joke. An actual fact of what we call

the "great" that is the "great" and "great" is

in fact how much more to deal with the world in

the world now.

THE CHAIRMAN: There was very much.

Professor [Name], it has been a most interesting

discussion. We have heard a very great deal about

the "great" and the "great" and the "great" and the

the "great" and the "great" and the "great" and the

the "great" and the "great" and the "great" and the

the "great" and the "great" and the "great" and the

We shall now adjourn. The next

meeting will be held on Tuesday, October 14, when

we shall hear [Name] and the Honorable [Name]

of [Name] and [Name] and [Name] and [Name] and [Name]

---Adjourn.

THE CHAIRMAN: There was very much.

# Royal Commission on Banking and Finance

PROFESSOR PAUL A. SAMUELSON

Hearings  
held at  
OTTAWA

Vol.

45A

Date.

October 19, 1962



Official Reporters  
F.J. Nethercut and R.J. Young  
Toronto, Ont.







*Nethercut & Young*  
*Toronto, Ontario*

A. 1

MEMORANDUM

for

THE ROYAL COMMISSION ON BANKING AND FINANCE, CANADA

Paul A. Samuelson

October 19, 1962.







1                   1. Introduction.    As an economist who has  
2                   studied for some considerable time problems involving  
3                   money, credit, banking, aggregate output, price levels  
4                   and international finance, I am glad to give briefly  
5                   my views on certain basic policy and institutional  
6                   problems in the field of central banking, fiscal policy,  
7                   debt management and international finance. It is  
8                   evident that I am not an expert on the peculiarly  
9                   Canadian aspect of these problems, and it is with some  
10                  diffidence that I touch on those special features of  
11                  the Canadian case that seem too important to ignore.  
12                  Because of space limitation, much of the discussion  
13                  will lack the subtle qualifications that would be  
14                  appropriate to a more leisurely survey, and that might  
15                  be developed in oral interrogation. (The fine-print  
16                  paragraphs, which can be skipped, contain some elab-  
17                  orations.) Finally, because I speak only for myself  
18                  and as a professor of economics, I may possibly be  
19                  forgiven resort to pungent language denied to those  
20                  in official position. Here then is a brief summary  
21                  of my views on a number of the important questions  
22                  that have been under examination and discussion by  
23                  authorities in the general field of monetary policy.





1                    I. General Powers of Monetary Policy

2                    2. Monetary policy potent. Contrary to the  
3 opinions of many contemporary economists (and to some  
4 of my own earlier views) I believe that monetary and  
5 credit policies have great potency to stimulate,  
6 stabilize, or depress a modern economy. This belief  
7 is based on my evaluation of the tremendous amount of  
8 empirical data thrown up by (1) history, (2) current  
9 statistics and (3) case studies of business behavior.  
10 These data are diverse, conflicting, and often in-  
11 conclusive and have therefore to be interpreted with  
12 the help of all the tools of economic analysis  
13 inherited from the past and developed by the present  
14 generation of scholars.

15                    3. Money not all-important. In thus  
16 differing from the pessimists, I want to make clear  
17 that I am not agreeing with that much smaller group  
18 of older economists who think that monetary policy by  
19 itself is the sole or principal mechanism for controll-  
20 ing the aggregative behavior of a modern economy.  
21 I believe such a view to be factually wrong or  
22 irrelevant; and would add that even if monetary  
23 policies truly had this exaggerated degree of potency,  
24 I would not deem it optimal social policy to rely  
25 exclusively or primarily on that weapon alone.

26                    4. Money a social responsibility. Today all  
27 experts dismiss the ancient view that laissez-faire  
28 can properly hold in the field of money and banking.  
29 "Money will not manage itself." Banking institutions  
30





THE UNIVERSITY OF CHICAGO

One of the main purposes of this study is to determine the effect of the various factors on the rate of reaction. It is found that the rate of reaction is affected by the concentration of the reactants, the temperature, and the presence of a catalyst.

The rate of reaction is found to be directly proportional to the concentration of the reactants. This is shown by the fact that when the concentration of the reactants is doubled, the rate of reaction is also doubled. The temperature also affects the rate of reaction, and it is found that the rate of reaction increases as the temperature increases. The presence of a catalyst also affects the rate of reaction, and it is found that the rate of reaction increases when a catalyst is present.

The effect of the concentration of the reactants on the rate of reaction is shown in the following table. It is found that the rate of reaction is directly proportional to the concentration of the reactants. The effect of the temperature on the rate of reaction is shown in the following table. It is found that the rate of reaction increases as the temperature increases. The effect of the presence of a catalyst on the rate of reaction is shown in the following table. It is found that the rate of reaction increases when a catalyst is present.

The following table shows the effect of the concentration of the reactants on the rate of reaction. It is found that the rate of reaction is directly proportional to the concentration of the reactants. The following table shows the effect of the temperature on the rate of reaction. It is found that the rate of reaction increases as the temperature increases. The following table shows the effect of the presence of a catalyst on the rate of reaction. It is found that the rate of reaction increases when a catalyst is present.



1 are not perfectly-competitive self-regulating enter-  
2 prises that can be free from strict governmental  
3 regulations and controls. They are "public utilities  
4 vested with public interest" and the same is true in  
5 equal or lesser degree of various financial intermed-  
6 iaries such as saving institutions, finance companies,  
7 insurance concerns. Let me make clear that all this  
8 is stated from the standpoint of one who philosophically  
9 values individual freedoms. A person who cheerfully  
10 accepts the idea of direct price, wage, and production  
11 controls can afford to give a relatively large measure  
12 of freedom to credit institutions; but one who wishes  
13 to minimize (except in emergency periods) the use of  
14 such direct controls will realize that we maximize  
15 total freedom in a society by limiting it in the areas  
16 which crucially determine the aggregate of effective  
17 demand. In summary:

18           A responsible policy of government control  
19           of monetary and fiscal policy is a primary  
20           weapon in the battle for a well-running  
21           market economy.

22           5. The folly of simple formulas. I must  
23           firmly disassociate myself from the small but important  
24           group of writers who, agreeing that money will not run  
25           itself, go on to argue that it ought to be determined  
26           permanently by certain automatic formulas. Sometimes  
27           this is put in the fancy language of "rules versus  
28           authorities," or "laws versus men" or, "automaticity  
29           versus discretionary action." Of course no one,  
30







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A. 5

1 myself included, will admit to favoring arbitrary  
2 caprice of bungling rulers over the even-handed justice  
3 of well-formulated rules. If every form of explicit  
4 cooperative action set up by men is bound to be  
5 completely nearsighted, venal, and blundering then  
6 recourse to astrological rules might pragmatically be  
7 defended -- although no wise man could have any secure  
8 belief that such bungling human beings would ever bind  
9 themselves and stay bound to such arbitrary mechanisms.  
10 The vicissitudes of ancient coin standards -- which  
11 were at the mercy of the accidental discovery of  
12 precious metals in Latin America, Australia,  
13 California, Alaska, South Africa, and now Soviet Russia  
14 -- would certainly be preferable to some forms of  
15 "managed money." In practise though, there have  
16 always been -- both for good and evil -- substantial  
17 departures from any automatic coin, bullion or other  
18 kind of gold standard. In principle the choice has  
19 never been between discretionary and non-discretionary  
20 action: for when men set up a definitive mechanism  
21 which is to run forever after by itself, that involves  
22 a single act of discretion which transcends both in  
23 its arrogance and its capacity for potential harm any  
24 repeated acts of foolish discretion that can be  
25 imagined. Since I have argued elsewhere (1,2,3) the  
26 philosophical principles involved in this choice and  
27 have never seen any written refutation of these  
28 arguments by adherents of the "automaticity" school  
29 I shall merely state here that the relevant choices  
30 have to be made pragmatically in terms of the goodness





1 or badness of behavior patterns that result from  
2 various kinds of discretionary action.

3  
4 6. The folly of a pre-ordained stipulated  
5 trend in money supply. Specifically consider the  
6 suggestion of a money supply which is to grow at  
7 exactly 3 per cent per year, a policy advocated by  
8 some who think no other actions would then be required.  
9 Suppose this had been enacted in the United States in  
10 a random recent year without knowledge of the balance-  
11 of-payments problems just ahead and without knowledge  
12 of the massive shift to time deposits such as we have  
13 been experiencing both as a result of raised interest-  
14 rate ceilings on such deposits and the natural shift to  
15 such deposits as interest rates generally rise. The  
16 results could have been quite bad in comparison with  
17 what actually happened; and if the balance-of-payments  
18 situation had for unpredictable reasons been a great  
19 deal worse, the results could have been disastrous.  
20 I realize the adherents of such proposals will argue:  
21 such dire results might have been avoided if there had  
22 been floating exchange rates, perfectly flexible wage  
23 rates, and never, never any interest-rate or other  
24 ceilings. But since we do not and shall not live in  
25 such a never-never land, legislating part of the package  
26 would surely do more harm than good.

27 7. Money control and aggregate spending.  
28 There are thousands of reasons why any automatic  
29 gadget can be improved upon by decision-makers, even  
30 by fallible decision-makers. This statement will be







1 denied by those who are firm believers in the ancient  
2 Quantity Theory of Money. If it were true in a causal  
3 sense that there is an invariant relationship between,  
4 on the one hand, total dollar income and spending, and,  
5 on the other, the supply of money defined in such a way  
6 as to be capable of predetermination by the central  
7 bank, then an autogyro which kept total money supply  
8 growing smoothly would, by hypothesis, keep total  
9 money income growing smoothly. While I know that  
10 some modern scholars have tried by historical studies  
11 to establish an empirical concomitance between money  
12 supply and aggregate income, let me simply state here  
13 that I find the implied proof of a simple, controllable  
14 causal proportionality relationship unconvincing.

15  
16 8. Ability of change in general monetary  
17 conditions to affect total spending in the desired  
18 direction. It is the easiest sport in the world to  
19 shoot down any crude formulation of the Quantity  
20 Theory. But I think it quite illegitimate to conclude  
21 from this what the Radcliffe Committee and many modern  
22 scholars have stated: namely, if total money supply,  
23 M, does not invariably create an exactly proportional  
24 total income and product  $Y = MV$  -- because, as  
25 they so nicely put it, the income velocity of circula-  
26 tion of money, V, is not a constant -- it follows that  
27 we should turn our attention away from conventional  
28 central bank controls and rely instead on some global  
29 concept of "liquidity." As will become evident, I  
30 attach considerable importance to various concepts







1 of liquidity. But I think it wrong to believe that  
2 recognizing such concepts should undermine the belief  
3 that conventional central bank operations of open-  
4 market purchase and sale of securities, discount  
5 lending, and reserve-rate changing are likely to have  
6 important effects upon the total of investment and  
7 consumption spending. Emphasizing "liquidity" quite  
8 properly serves to debunk a crude quantity theory,  
9 and it thereby scores a fatal point against advocates  
10 of simple automaticity gadgets. But it leaves the  
11 position I am here expounding unscathed and it is for  
12 this reason that a number of reviewers have criticized  
13 the Radcliffe Report. (The average quality of all the  
14 reviews of Radcliffe is probably lower than that of  
15 the document itself; among the best reviews, I should  
16 like to mention that of Professor John Gurley of  
17 Stanford in the American Economic Review, Vol. L,  
18 No. 4, September 1960.)

19 a. Because of the human temptation to reify  
20 any concept that has been defined and to tend  
21 to think as approximately constant the last  
22 variable that one has defined, I do not find  
23 the velocity variable,  $V$ , a very useful one.  
24 But older economists did, and some younger  
25 ones are beginning to again. So I shall  
26 restate the heart of the matter in such  
27 terms. If the requisite  $V$  were a strict  
28 constant,  $P \times Q$  would by hypothesis be exactly  
29 proportional to the requisite definition of  
30 money,  $M$ . Experience shows that  $V$  is not a





1 constant: it shows certain historical trends in the  
2 long run; in the course of the business cycle, it has  
3 generally shown fluctuations that are sympathetic with  
4 the cycle itself, rising in good times and falling in  
5 bad; after more studies have been made, I believe V  
6 will also show certain fluctuations with interest rate  
7 and other conditions, tending other things equal to  
8 rise when interest rates are high and the opportunity  
9 cost of cash balances is great and tending to fall  
10 when short term investment opportunities all have a  
11 very low yield; the behavior of V will also be quite  
12 sensitively affected by the particular concept of the  
13 money supply that is adopted, being quite different if  
14 currency alone is considered (as with the nineteenth  
15 century Currency School and Edwin Cannan in the 1920's)  
16 than if demand deposits are included and various  
17 categories of time deposits and close money substitutes  
18 are or are not included in the definition of money.  
19 Some of the movements of V will be erratic and  
20 relatively unpredictable; others will be in some  
21 measure predictable. In particular, although they  
22 are operationally hard to identify in the empirical  
23 record, there can always be expected certain changes  
24 in V that are themselves induced by the change in M  
25 itself and, certain other things being held constant,  
26 are part and parcel of such a change in M. Some  
27 sensible probability statements can be made about  
28 these induced changes in V at various phases of the  
29 business cycle and at various time points in history.  
30 Now if it were the case that recognition of the







1 importance of money substitutes and various concepts  
2 of liquidity were to imply that changes of M in one  
3 direction can be expected to be followed systematically  
4 by opposite changes in V just large enough to offset  
5 any resulting induced changes in  $MV = PQ$ , then the  
6 casual reader of the Radcliffe Report would be right  
7 to think that central banks are unable to affect  
8 significantly aggregate spending by conventional open-  
9 market and lending operations. But none of the  
10 testimony or arguments in connection with the Radcliffe  
11 Committee succeed, in my judgment, in establishing a  
12 presumption in favor of this doctrine of Induced-  
13 velocity-changes-that-just-offset-money changes.

14 b. Not only is this not demonstrated in the  
15 historical record, but in addition such a finding is  
16 not in accordance with that type of analysis which is  
17 thought to have displaced the old Quantity Theory.  
18 For, in the various Keynesian models, there is  
19 generally a presumption that an increase in M  
20 engineered by the central bank will cause such a  
21 reduction in interest rates and increase in credit  
22 availability as to generate an increase in investment  
23 and total spending just large enough to create an  
24 extra level of income to absorb in transaction  
25 balances the new increment of money created. While  
26 the mechanism just described holds for the most  
27 primitive Keynesian model, the same conclusion is  
28 found to be valid for more sophisticated models, which  
29 pay explicit attention to wealth and other stock  
30 effects and which distinguish a long chain of assets







1 that range from being very near to money (like short-  
2 term government bonds) to being very illiquid and  
3 difficult to sell or evaluate (like built-in machinery  
4 that is highly specific to a particular location and  
5 owner). And the qualitative nature of the conclusion  
6 -- that the central bank can expand spending by  
7 expansive open-market, lending, and reserve-rate  
8 fixing operations -- will still hold even after we  
9 have admitted the existence of relatively-less-con-  
10 trolled financial intermediaries like saving banks,  
11 finance companies, insurance companies, mutual or  
12 unit-trust funds, and various forms of equity and loan  
13 participants. (With his permission, I will refer  
14 briefly to an interesting demonstration by Professor  
15 James Tobin of Yale in an unpublished manuscript  
16 privately circulated several years ago: Suppose that  
17 we have a chain of substitutes, which instead of  
18 being called tea, coffee and coca are called bank  
19 money, short-term bonds, long-term bonds, insurance  
20 assets, and so forth; call them  $M_1$ ,  $M_2$ , ... and  
21 suppose that their respective prices are  $N_1$ ,  $N_2$ , ...  
22 If the central bank could decrease all of the  $M$   
23 totals together by operations and fiats that apply  
24 to insurance companies as well as to banks and to  
25 all financial intermediaries, then no one doubts that  
26 the total of "liquidity" however measured would go  
27 down and that this would, other things equal, tend  
28 to have a depressing effect on aggregate spending  
29 and general inflationary pressures. Specifically,  
30 with every  $M_1$  decreasing because of direct central





1 bank action, the unweighted or weighted sum of the  $M$ 's  
2 and every other recommended measure of "liquidity"  
3 would also go down. But now suppose that the central  
4 bank can only decrease directly  $M_1$ , having no direct  
5 controls on the reserve-ratios or totals of any other  
6 sectoral  $M_1$ . A reader of the whole of the Radcliffe  
7 Report and Hearings might be forgiven for inferring  
8 that in this case nothing positive could be said about  
9 the ability of the central bank to affect total  
10 liquidity, as measured by some kind of total of the  
11  $M$ 's or weighted-sum of the  $M$ 's or other measure of  
12 liquidity; and hence, that we should abandon the simple  
13 notion that a modern central bank can by its conventional  
14 operations push aggregate spending in a desired direction.  
15 Tobin, however, in his unpublished memo, has shown  
16 that provided the  $M$ 's are all substitutes (in the  
17 sense that the excess demand for each  $M_i$  decreases  
18 when its own  $N_i$  price rises but increases when some  
19 other  $M_j$ 's  $N_j$  goes up -- as for example that an  
20 isolated increase in the price of short-term bonds  
21 should cause less of them to be demanded and more of  
22 long-term bonds to be substituted for them), then the  
23 central bank can cause every  $M_1$  to go down by simply  
24 depressing  $M_1$  ! (The theorem is like the Leontief  
25 one which says that raising the consumption  
26 requirements for hats must raise gross output of  
27 every good in a well-behaved input-output system,  
28 and like the Metzler-Keynes theorem that an increase  
29 in domestic investment in one country must to some  
30 degree raise outputs everywhere in a well-behaved







many-sector multiplier model.) This important Tobin result accords well with intuition. One should not push it beyond its actual statement: each indirect effect is generally speaking, weaker than each direct effect and the central bank may have to push undesirably harder on  $M_1$  to get the same change in over-all  $M$ 's than it would have to do if it were given direct powers to affect financial intermediaries.\* As will become evident later, the case against bills only is not vitiated by the Tobin argument. Later too I shall have to point out some important limiting cases where the potency of central bank action becomes quantitatively zero or almost zero.

9. The asymmetry of monetary policy's effectiveness. It has often been said that monetary policy is more effective in contracting an economy than in getting it to expand. There is an important grain of truth in this observation: thus when Bank Rate or the Discount rate is six or seven per cent and the commercial banks' excess reserves are at a minimum and the business community is heavily dependent upon bank borrowings for its current investments in inventories and other items, then further restrictive

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\*This corresponds to a theorem that, in appropriate units  $\left| \partial N_1 / \partial M_1 \right| > \left| \partial N_j / \partial M_1 \right| > 0$  for certain systems of Leontief, Metzler, and Mosak-Hicks type, as has been recognized by diverse writers such as Hicks, H. Johnson, Morishima, and others. It does not deny that in certain limiting cases of perfect substitution these effects will be equal, or that in certain limiting cases one or both may be zero.







1 action by the central bank can by a variety of channels  
2 cut deeply into the aggregate of investment and total  
3 spending. On the other hand, in a period like the  
4 1930's when the market yield on short-term government  
5 securities has already been driven down to a fraction  
6 of a fraction of one per cent and when banks have  
7 copious excess reserves and business firms are  
8 regretting their past investing and regarding the  
9 marginal profitability rate on all further investments  
10 as negative, there would be little potency indeed in  
11 conventional central bank operations: buying short-  
12 term bonds in the open market would then merely take  
13 from the community a very close money substitute and  
14 replace it by money itself, being incapable of having  
15 much further depressing influence on the interest rate  
16 structure and being incapable of making credit more  
17 readily available to borrowers (who are in any case  
18 virtually non-existent and automatically regarded  
19 as suspiciously risky chaps if they should come  
20 forward with a loan application). From the  
21 technical fact that monetary policy works more  
22 effectively at high than at low interest rates, no  
23 one should make the mistake of concluding that the  
24 goal of policy should be to avoid low rates. Forks  
25 must be made to fit fingers not fingers forks:  
26 when an economy will suffer from tight markets and  
27 the technician will benefit, it is of course the  
28 technician who must properly give way.

29 a. This last case then is one where an  
30 induced change in velocity can be expected





1 to wipe out almost completely any contrived  
2 change in money narrowly defined. It is the  
3 case often referred to as the Depression-Keynes  
4 model, where (1) there is a liquidity trap near  
5 to a zero rate of pure interest, at which the  
6 Keynesian liquidity preference schedule is  
7 practically infinite in elasticity so that  
8 the system will absorb great amounts of M at  
9 practically the same interest rate and credit-  
10 availability, and/or where (2) the rate of  
11 investment spending is almost completely  
12 inelastic with respect to changes in the  
13 interest cost and availability of credit.  
14 I believe, in the face of some doubters, that  
15 such a depression model has occasional  
16 empirical validity -- certainly in the short  
17 run and possibly for a vexingly long time.  
18 Moreover, bitter experience in the United  
19 States of the last few years leads one to  
20 suspect that it is not always so easy to  
21 engineer a deepening of capital by conventional  
22 central bank operations even when one is not  
23 in a deep-depression liquidity trap: for,  
24 even when gilt-edge rates are lowered farther  
25 and farther, the effective profit rates that  
26 businessmen must anticipate to get them to  
27 make somewhat risky investments may remain  
28 quite high -- say 15 per cent before corporate  
29 taxes or 8 per cent after taxes - and even  
30 massive open-market purchase of government







1 bonds may not be able to push the system down  
2 through a high-profit floor that acts rather  
3 like the older Keynes liquidity trap interest  
4 floor in keeping investment resistant to  
5 expansion.

6 b. I know it can be argued that the central  
7 bank, provided it is ready to abandon notions  
8 of feasibility and force the market rates of  
9 interest up to 40 per cent in boom times and  
10 down to zero, or for that matter down to  
11 negative rates of interest, can control the  
12 amount of total money and spending activity  
13 to any desired levels regardless of adverse  
14 fiscal policies and adverse behavior pro-  
15 pensities on the part of business and the  
16 public. Personally, I consider it irrele-  
17 vant to talk about 40 per cent bank rates  
18 and in any case undesirable to put the  
19 burden of such extreme adjustments on the  
20 narrow sectors most affected by monetary  
21 actions. And as far as forcing extremely  
22 low interest rates is concerned, it is  
23 simply not true that lending money to  
24 people at negative interest rates is  
25 guaranteed to result in any desired  
26 expansion in spending: making gifts might,  
27 but if these are loans that have to be paid  
28 back, it would be rational for people to  
29 borrow at negative interest rates and just  
30 hold the proceeds in safety lock boxes,







1           thereby earning a handsome yield. The total  
2           of something called M might rise, but that  
3           does not mean that the requisite MV can be  
4           achieved in any short period by conventional  
5           central bank operations. My purpose here is  
6           not to score a point against some extreme  
7           Quantity Theory formulation, but to call  
8           attention to the fact that in many social  
9           situations a well-running democracy will want  
10          its central bank to engage in unconventional  
11          activities. (Examples: in the 1930's Federal  
12          Reserve Banks made loans directly to certain  
13          small businesses; in a future balance of  
14          payments crisis the central bank might want  
15          to provide certain guarantees and investment  
16          insurance to desired domestic investments  
17          while keeping up the yields on short-term  
18          government bills; and the day could come  
19          when the central bank would want to make  
20          loans at negative interest rates to applicants  
21          who satisfied certain requirements, such as a  
22          guaranteeing that the proceeds would go into  
23          resource-using investment; if laissez-faire  
24          conditions should prove to choke off deepening  
25          of capital when profits rates are still as  
26          high as 10 per cent and conventional credit  
27          operations proved not able to overcome this,  
28          the intrinsic logic of central banking requires  
29          recourse to new unconventional programs.)

30           c. Finally, I once felt it necessary to





1 point out a minor flaw in certain descriptions  
2 of the asymmetry of monetary policy's potency.  
3 It is not correct to say that monetary policy  
4 can contract an economy more easily than it can  
5 expand it. In buoyant times when interest rates  
6 are already high and credit already tight,  
7 monetary policy is very potent both to expand  
8 and contract the system from its previous  
9 situation; in slack times when interest rates  
10 are near the floor and the system is swimming  
11 in liquidity, monetary policy is very impotent  
12 both to contract or expand the system from its  
13 previous level. Thus, the true asymmetry is  
14 not that depicted by a corner in the schedule  
15 relating general activity and central bank  
16 activity, with the slope for an up movement  
17 being greatly different from the slope for a  
18 down movement; the asymmetry merely refers  
19 to the putative difference in slope at any given  
20 point in a slack as against a tight credit  
21 market.

22 d. Central Bankers abhor a situation which  
23 they feel is not closely responsive to their  
24 control. So they naturally dislike being so  
25 expansive as to create a "sloppy market." As  
26 shown above, the consequences of this abhorrence  
27 may not be too costly in the short run; yet  
28 they should often brave the displeasure of  
29 commercial bankers (who abhor sloppy markets  
30 for the good commercial reason that such markets







are hard on bank earnings) and flood the market with a view to the longer-run stimulus in investment that may come from gradual penetration of alleged liquidity-trap floors. One has no right to assume away such longer-run benefits from a policy of "over ease." The central banker will tend to feel that the cost of such a policy will be the danger that in the subsequent recovery period the redundant credit, which had previously done no harm and done precious little good, will come to life and create the possibility of an over-fast expansion and of undue inflationary pressures. This is just another aspect of his reluctance to let the money market get out of his immediate control. While recognizing some merit in this view, I would point out that the goal of policy is not to minimize the unease of central bankers; they are supposed to suffer psychic pain when that is in a good cause. Moreover, some quickening in their contractionary actions early in the recovery may serve to undo much of the harm to be expected from an earlier policy of over ease, and such a quickening would in many cases be a worthwhile price to pay for improving the slump situation. What I am saying here would not be so important if the only thing to fear were a regular cycle involving a recession known to be short lived. But when an economy moves into an epoch when







1 profit rates are sluggish (having been competed  
2 down by the plentifulness of capital stock  
3 relative to labor, and the nature and speed of  
4 contemporaneous technical change) and investment  
5 is hard to coax out at still lower profit rates,  
6 the best policy for conventional central banking  
7 operations is to keep the money market flooded  
8 with reserves, with a view to eroding gradually  
9 resistant long-term interest rates and the profit-  
10 rate floors that businessmen insist upon getting  
11 if they are to make resource-employing invest-  
12 ments. Specifically, in the U.S. environment of  
13 the 1930's it was right to have great excess  
14 reserves and minimal short-term rates: the  
15 slow, too-slow, drop in long-term interest  
16 rates was thereby encouraged. With due regard  
17 to future international payments considerations,  
18 the same strategy will be needed in certain  
19 future times; and American central bankers  
20 are wrong to reproach themselves for over  
21 ease in the 1953-4 and 1957-8 recessions.

22 e. Zealots for monetary policy are,  
23 somewhat pardonably, infuriated by a related  
24 asymmetry that used to be argued by critics.  
25 These critics would say in one breath,  
26 "Monetary action is practically impotent,"  
27 and in the next breath they would add, "But  
28 using monetary policy determinedly will  
29 plunge the system into a crisis and major  
30 depression." This argument is thought to



... are also... (having been compared  
down by the scientific of capital stock  
relative to labor, and the nature and speed of  
contemporaneous technical change) and investment  
is hard to coax out at such a low profit margin.  
The last policy for conventional capital markets  
operations is to keep the money market floating  
with interest, with a view to enabling firms to  
obtain long-term interest rates and to  
make it a fact that the economy is not too  
to and to make investment in the future -  
central, local, in the U.S. or abroad -  
the future of the world is a great concern  
to make and which are the basis of  
from the above, then in the future interest  
rates are thereby determined. With the  
to make international payments convertible  
the rate, which will be based on a  
from the U.S. and from the world market  
the work to support the dollar for over  
case in the world and in the future.  
a. To make the monetary policy and  
economic growth, which is a result  
economy that need to be given by others.  
These ratios would say in one breath,  
"Monetary policy is practically impossible,"  
and in the next breath they would add, "But  
many monetary policy decisions will  
plunge the system into a crisis and major  
...". This argument is thought to



involve almost a self-contradiction. How can a thing be simultaneously both weak and strong? Formally, this can be saved from being utter nonsense by modifying it to say, "For a small exercise of monetary policy, the results will be not only small but disappointingly small; for a really large exercise, the results will be disastrously large." To this defenders of the view that M can take care of everything will naturally reply, "Aha then, it is really only a matter of using the right (intermediate) dosage." On the whole I have to agree with this defense of monetary policy, particularly in the historical context of the postwar U.S. debates as to whether letting War Bonds fall below par would entail uncontrollable disaster. But in terms of the logic of all the situations that could possibly arise, two qualifications ought to be made. 1) If the response to a control lever satisfies a function that changes suddenly from a low slope to a high one, and at an unknown spot, then a correct dosage is extremely hard to reckon or to work out experimentally; so in some, perhaps rare and unrealistic, situations the asymmetry arguments of the pessimists might have a measure of validity. 11) There is a second complication that may have been envisaged by users of this asymmetry argument, namely the possibility that in certain situations market expectations





1 are important with investment demand depending  
2 on the bond prices that the central bank  
3 engineers and also on the rate of change of  
4 prices; given differential equation relationships  
5 of the form  $F(I, P, dp/dt, M, \dots) = 0$ , there could  
6 result discontinuities in the solutions. An  
7 example would be the case where shovelling a  
8 little snow up hill may, at an unknown and  
9 quite unpredictable point, set off an avalanche  
10 of snow. To say in such a situation, "It is  
11 only a question of the right intermediate  
12 dosage" is to miss the point.

13 10. The fallacy that monetary policy controls  
14 price levels and fiscal policy controls output levels.

15 It was once widely believed, and some central bank  
16 authorities still believe it, that the central bank  
17 operates to control money, or  $M$ , and that  $M$  operates  
18 directly to control the price level,  $P$ . In the old  
19 days the quantity of output,  $Q$ , was not thought to  
20 need determining by any particular agency, since  
21 something like full employment was more or less taken  
22 for granted; in more recent decades, holders of the  
23 present view have been prone to think of government  
24 fiscal policy as somehow having the ability to control  
25  $Q$  with monetary policy controlling  $P$ . Later I shall  
26 deal with proper goals of central banking and shall  
27 be critical of the view that price stability has per  
28 se primacy. The point I want to make here is a  
29 purely mechanical one and has nothing to do with  
30

on the hand prices that the [company] paid





1 subjective value judgments. It is simply untrue  
2 that money and credit programs have any way of  
3 peculiarly affecting the P or price factor: successful  
4 monetary expansion will, as I have shown above, have  
5 some favorable effect on the dollar value of total  
6 output  $P \times Q$  and so will expansionary fiscal policy;  
7 the resulting change in  $P \times Q$  will get distributed  
8 between expansion in Q as against expansion in P,  
9 depending upon how much or how little labor and  
10 capital remains unused to be drawn on and upon how  
11 strong or weak are the cost-push upward pressures  
12 that come from the institutional supply conditions  
13 of organized and unorganized labor, of oligopolistic  
14 price administrators and more perfectly-competitive  
15 enterprises. No one has been able to establish any  
16 presumption that either monetary policy or fiscal  
17 policy has some special impact upon the price as  
18 against the output factor. Indeed one cannot too  
19 often correct the view widespread among non-economists,  
20 that a "natural" upswing in consumption or investment  
21 spending is less inflationary than an equivalent  
22 upswing in aggregate spending,  $P \times Q$ , brought about by  
23 deliberate public policies. (It is true that one  
24 expects a somewhat different mix of expenditure to  
25 result from new investment spending induced by credit  
26 policy than from new consumption spending induced by  
27 tax rate reduction. Likewise a private inventory  
28 boom will encounter price rises from bottleneck  
29 pressures different from those of a private equipment  
30 boom or those of a defense boom. But there is no



...with the ...

...money and credit ...

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1 differential price-level presumption associated in  
2 general with deficit, credit, or private stimulation.)

3  
4 a. I have been careful in all earlier  
5 technical notes to state the Quantity Theory  
6 of Money in terms of proportionality between  
7 M and  $PXQ$ , rather than in the older terms of  
8 proportionality between M and P. The first of  
9 these formulations has the advantage that it  
10 allows real output to increase considerably  
11 from an underemployment situation without there  
12 having to be much price rise up to the time that  
13 bottlenecks and resource scarcities appear; it  
14 allows also for the occurrence of "sellers '  
15 inflation", in which there may be an upward push  
16 on prices from the wage, profit, and raw material  
17 cost side. Since V and Q both tend to rise with  
18 the business cycle, Irving Fisher and older  
19 writers thought that the ratio of P to M might  
20 be approximately constant; however the facts of  
21 the last 40 years do not accord well with such  
22 an hypothesis.

23 b. Facts aside, there is one model or case  
24 in which the older Quantity Theory would indeed  
25 be true. Imagine a new situation in which every  
26 price and every value magnitude has exactly  
27 doubled or halved, so that all price ratios and  
28 real quantities are absolutely unchanged. The  
29 essence of money--be it shells, or gold, or bits  
30 of paper and in contrast with drinkable coffee or







1 any good where consumption gives psychic satis-  
2 faction--is that we want it only for its ultimate  
3 indirect utility in getting goods that can give  
4 direct utility. Basically, we want to hold money  
5 only in order to be able to spend it some day in  
6 exchange for something directly useful. Therefore,  
7 when all prices have exactly doubled or halved  
8 while all real magnitudes and exchange ratios  
9 and interest rates have stayed exactly constant,  
10 the desired amount of money holding can be thought  
11 of as exactly doubling or halving. In this  
12 sense and situation, there is an underlying truth  
13 in a strict Quantity Theory that makes P and M  
14 exactly proportional. (Technically, economists  
15 describe this by saying that all real quantity  
16 relations are homogeneous of degree zero in all  
17 absolute prices and all value magnitudes like  
18  $p_1 \times q_1$  are homogeneous of degree one in terms of  
19 all p's; hence the needed amount of money -- the  
20 number of wampum beads or ounces of gold or items  
21 of paper currency is a homogeneous function of  
22 degree one in all the prices when expressed in  
23 terms of that unit. Note that whenever a  
24 substance used as money also has a direct utility  
25 -- as in the case of gold for teeth or of beaver  
26 skins for coats -- this strict Quantity Theory no  
27 longer applies: double the amount of beaver  
28 skins by central bank or other activity and the  
29 price of wool will not double even if the price  
30







1 of mousetraps should.\* Note too that this version  
2 of a quantity theory would hold even if the real  
3 part of the model were different from the classical  
4 one involving full employment, as in the case of  
5 some of the deep-depression Keynesian models of  
6 underemployment where so-called Pigou-effects were  
7 deemed not to operate. If the economist stipulates  
8 a real model that lacks unique equilibrium, then  
9 a change in absolute price levels might jar the  
10 system from one admissible equilibrium to another,  
11 thereby jeopardizing the "neutrality" of money.)

-----  
12 \*From this formulation it will be evident that  
13 along with the total of any useless M stuff, be it  
14 shells or metal or fiat paper money that represent  
15 non-interest-bearing I.O.U.'s of the government,  
16 we should also take account of any interest bearing  
17 I.O.U.'s of the government (which people think of  
18 as an asset but fail to think of as involving a  
19 personal liability for future taxes). The strict  
20 Quantity Theory now says: double fiat M and fiat  
21 government bonds and you will exactly double all  
22 prices and values in a classical model that has  
23 all its real magnitudes and relative prices  
24 unchanged. These fiat bonds are important without  
25 regard to the fact that they are useable directly  
26 for exchanges or are close money substitutes. As  
27 will be seen shortly, some conventional credit  
28 operations that involve the same change in M will  
29 differ markedly in their "Pigou effects" and potency,  
30 a fact ignored by simple-minded theorists.





1           b. Simple models do great good in clarifying  
2 issues. They can also do great harm if carelessly  
3 applied to real life in all its complexity.  
4 History does not record nicely balanced changes  
5 in all prices that are as neutral with respect to  
6 real effects as would be a dimensional transform-  
7 ation in which one chooses to reckon in terms of  
8 cents rather than dollars or in terms of dozens of  
9 eggs rather than single ones. And what is more  
10 relevant, when the central bank increases one or  
11 another measure of the money supply by 10 per cent,  
12 this will not, and cannot, result in a nicely  
13 balanced change in all prices and values. It  
14 literally cannot do so because all past contracts  
15 and past prices are already determined: as a  
16 debtor your real position is altered by this new  
17 change in M, just as my position as a creditor  
18 is altered. Nor is there the slightest guarantee  
19 that what I gain you will lose, since there is no  
20 law of conservation of total well-being under such  
21 a change. Indeed, since the time of David Hume it  
22 has been generally thought that mild unexpected  
23 price rises tend to expand the degree of utilization  
24 of resources and to channel resources into the hands  
25 of the more active entrepreneurial elements at the  
26 expense of more inert classes. During periods of  
27 mild or severe inflations certain changes in  
28 relative prices have been considered to be  
29 characteristic.

30           c. While the conditions for a strict Quantity







1 Theory to be valid or unrealistic, they probably  
2 become somewhat less so in the long run. I suspect  
3 that after more research has been done we shall  
4 learn that many of the systematic changes in  
5 relative prices induced by transitional inflations  
6 are not so great as has been believed; for, it  
7 seems odd that continuing price rises should keep  
8 coming as a surprise to people. Moreover, the  
9 longer the run the less important will be the  
10 effects of past contracts and remembrance of lower  
11 levels of past prices. The past is, one supposes,  
12 as long as the future. But well-behaved and stable  
13 price systems tend to have the property of gradually  
14 "forgetting" the past. If that were not so, the  
15 way that the War of the Roses was financed would  
16 be as important for 1962 behavior as the sliding-  
17 scale wage contracts of 1961. So a once-and-for-  
18 all doubling of money will eventually imply that the  
19 distortion inherent in the fact that past prices  
20 certainly have not doubled will become less and  
21 less relevant. The simpler minded Quantity Theory  
22 is thus seen to have its greatest measure of  
23 empirical validity in the longest run. Having  
24 emphasized this kernel of truth, I must quickly  
25 add the warning that it is precisely in the long  
26 run that other things will not have remained equal:  
27 exogenous and endogenous shifts in the relations  
28 determining equilibrium will certainly have taken  
29 place, thereby vitiating any simple price-scale  
30 change as an interpretation of the empirical facts.

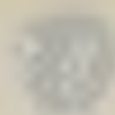


There is a certain amount of truth in the statement that the system of relative prices induced by the market is not as great as has been believed. It seems odd that continuing price rises should come as a surprise to people. Moreover, the former the run the less important will be the effects of past contracts and movements of levels of past prices. The past is, one might say, as long as the future. But well-behaved and rational price systems tend to have the property of gradually "forgetting" the past. If that were not so, the way that the War of the Roses was financed would be an important factor in behavior as the sliding-scale wage contracts of 1917. So a once-and-for-all doubling of money will eventually imply that the distortion inherent in the fact that past prices certainly have not doubled will become less and less relevant. The question is, however, whether it is thus seen to have its greatest measure of empirical validity in the longest run. Having emphasized this kernel of truth, I must quickly add the warning that it is precisely in the long run that what will not have seemed valid exogenous and endogenous shifts in the relations determining equilibrium will certainly have taken place, thereby vitiating any simple price-scale system as an interpretation of the empirical facts.





1           Even if one could rule out purely exogenous  
2           disturbances, real economic life does not consist  
3           of a return to the same pre-determined real equilibrium  
4           after a transient change in money supply.  
5           I live but once and if an inflation wipes out my  
6           real net worth that is an irreversible fact. The  
7           distribution of income and corporate power was never  
8           (including the position of Hugo Stinnes) quite the  
9           same after the 1920-23 German inflation: even if  
10          a Lorenz curve depicting the inequality of distribution  
11          of income or wealth begins to revert toward  
12          its earlier form, the class ownership of wealth  
13          could be permanently different. Even the same  
14          Lorenz curve will not imply the same people in  
15          the background and the same behavior propensities.  
16          Capitalism, as we know it today, would have probably  
17          been systematically different if Columbus had never  
18          discovered the New World with its vast areas of  
19          gold and silver. All that I have just been saying  
20          is rather hypothetical. But there can be no doubt  
21          that if Canada and the United States had followed  
22          policies which prevented the Great Depression of  
23          the 1930's, today in 1962 we would have an entirely  
24          different stock of capital goods. And it is wrong  
25          to argue that this means merely that we arrive in  
26          1962 at the state we would have otherwise reached  
27          in 1952 or 1945: to have arrived at our present  
28          "capital abundance" prior to knowing the discoveries  
29          of recent science would imply a qualitatively and  
30          quantitatively different pattern of economic history.



GOVERNMENT OF INDIA  
MINISTRY OF DEFENCE

MEMORANDUM FOR THE RECORD

SUBJECT: [Illegible]

1. [Illegible]

2. [Illegible]

3. [Illegible]

4. [Illegible]

5. [Illegible]

6. [Illegible]

7. [Illegible]

8. [Illegible]

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15. [Illegible]

16. [Illegible]

17. [Illegible]

18. [Illegible]

19. [Illegible]

20. [Illegible]

21. [Illegible]

22. [Illegible]

23. [Illegible]

24. [Illegible]

25. [Illegible]

26. [Illegible]

27. [Illegible]

28. [Illegible]



(Technically, the theorist describes all this by saying that every economic equilibrium displays important hysteresis effects, where the very location of the equilibrium position depends upon the actual historical path of the system and thus there can never be truly neutral changes in the absolute price level. As a craftsman, I could wish that reality corresponded to the mechanics of a system without hysteresis because this would make my task of analysing economic reality so much more pleasant and simple. But just as the purpose of evolution has not been to give central bankers an easy life, neither has it been to give theorists restful nights and plenty of time to play golf or chess. While my examples have been primarily taken from price rises, the hysteresis effects from price declines are greater still because of price and wage rigidities which persist even in the long run. The attempt after World War I to roll back the price rises by reverting to 1913 gold parities has aptly been compared to the act of running over a man and then backing up over him a second time to undo the first effects. The corpse would recognize hysteresis effects even if many of the best economists of that day did not. All this may seem abstract and admittedly it is expressed in technical language. Yet it does have fundamental economic implications. Simple believers in M as the determinant of total effective demand do not feel the need to distinguish between, say,





Department of the Interior, Bureau of Land Management, Washington, D. C.

Very truly yours,

Director, Bureau of Land Management

Enclosed for the Bureau of Land Management are two copies of the report of the

Commissioner of the General Land Office, dated at Washington, D. C.,

March 1, 1914, and a copy of the report of the

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1 an increase in  $M$  that comes from the Treasury's  
2 (or central bank's) printing new dollar bills and  
3 i) sending them to all family heads, or ii) lending  
4 them at interest to investors, or iii) spending  
5 them on subsidies to investors, or iv) buying  
6 back Treasury Bills with them. The same increase  
7 in  $M$  leads, they allege, to the same change in  
8  $P/Q$  (and by strict "homogeneity" reasoning to the  
9 same real magnitudes). This is of course patent  
10 nonsense in the short run, as they concede when  
11 challenged: Under i) consumption is presumably  
12 stimulated and interest rates, if anything raised;  
13 under ii) interest rate falls, and presumably  $V$   
14 too, depending upon how much Investment rises.  
15 Only in the longest run, if then, can one assume  
16 that the new  $M$  gets distributed "ergodically"  
17 (i.e., independently of its original point of  
18 entry): I say, if then, because at best the stock  
19 of capital is permanently different. Note that  
20 iv) is without direct Pigou effects and hence  
21 presumably permanently different.

22 d. Gustav Cassel's famous purchasing-power-parity  
23 theory of war-dislocated foreign exchange rates  
24 was, prior to its reformulation by Keynes and others  
25 as a mere condition of spatial price equilibrium,  
26 based originally upon precisely the homogeneity  
27 assumption I have just described. It could be  
28 applied precisely only to balanced inflation such  
29 as never took place around the time of World War I.  
30







1 As a matter of fact in such an hypothetical  
2 balanced inflation resulting from a mere change in  
3 the absolute amount of an essentially neutral money,  
4 we would not get any predictive power from the  
5 purchasing-power-parity formulation since in such  
6 a world of perfect flexibility the exchange rates  
7 would already be at their equilibrium; but to  
8 this Cassel would no doubt reply that his theory  
9 would have predictive powers in cases where there  
10 are only short-term transient departures from  
11 balanced inflation and deflation, and during such  
12 times his theory would point to the longer-run  
13 equilibrium. Eclectic defenders of the usefulness  
14 of the reasoning that underlies the strict Quantity  
15 Theory and purchasing-power-parity doctrines will  
16 gladly jettison the notion that a trillion-fold  
17 increase in 1920 German Marks will result in an  
18 exactly trillion-fold change in domestic prices  
19 and foreign exchange rates: it is enough for  
20 their purpose, and mine, to stress that such  
21 massive changes in  $M$  and related magnitudes will  
22 inevitably be associated with massive changes in  
23 price levels; and that such massive changes in  
24 price levels cannot take place if the total of  
25 currency, bank deposits, and related magnitudes  
26 are kept fairly constant.

27 11. Timing and dynamic lags. The effects of  
28 monetary policy are not instantaneous. This is not  
29 surprising since there are no effects in nature that  
30



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are kept fairly constant.

If Testing and cognitive level, two effects of

memory policy are not instantaneous. This is not

impossible since there are no effects in nature that



1 are secured instantaneously. Even when I turn my key  
2 in the lock, the fact that there are no perfectly  
3 rigid metals means that a slight twisting and delay  
4 is inevitably involved. But the intrinsic delays  
5 involved in effectuating monetary policy are much longer  
6 than this. It is widely believed that monetary policy  
7 delays are considerably less than those involved in  
8 fiscal policy actions -- such as public works. And  
9 this is considered to be one of the great advantages  
10 of monetary policy. Actually, though, not a great  
11 deal is known in this area and the empirical  
12 researches performed so far are only a beginning.  
13 (I found it interesting that Lord Cobbold of the  
14 Bank of England in his testimony to you referred  
15 to his experience of a six-months lag in monetary policy.)  
16 In commenting on the interrelations between fiscal and  
17 monetary policy I shall later have more to say on  
18 these problems of timing. In completing the present  
19 section on the general properties of monetary policy,  
20 I merely want to point out that the inevitable lags  
21 both underscore the lack of perfection to be expected  
22 from monetary control and condition the procedures  
23 to be followed in making optimal decisions. If  
24 monetary policy acted almost instantaneously and  
25 were subject to easy cancellations,\* the central  
26 -----

27 \*This inability to cancel out previous action without  
28 delay is the one valid argument, which I referred to  
29 in an earlier section, for not relying on the flooding  
30 of the money market in time of presumably short  
recession; note, though, the need to be able to  
forecast correctly the shortness of the recession.







1 bank would find its task a much easier one: thus it  
2 might not have to take anticipatory action prior to  
3 a turn down of business activity from a full-employment  
4 level; for many purposes it would be sufficient to  
5 recognize a turn after it had already happened, which  
6 would be a procedure relatively immune from the false  
7 forecasts of turns which always plague practical fore-  
8 casters. But once we recognize that lags of some  
9 considerable number of months are involved in securing  
10 the effect of new actions, there may be grave harm  
11 in a policy which tries to offset a new movement only  
12 after enough months have passed to make the direction  
13 of that movement terribly obvious. "Don't try to  
14 look over hills or beyond valleys," is the sage  
15 advice often given by those leary of our ability to  
16 forecast. This can be very bad advice, and in fact  
17 one has to be very arrogant concerning his under-  
18 standing of the exact degree of a government's  
19 ability to forecast to be able to set down this rule  
20 or any other specific rule concerning the sluggish-  
21 ness with which an adapting mechanism is to adjust  
22 and react to the information input available. If  
23 an airplane follows a relatively smooth path with  
24 moderate random errors superimposed on it, the  
25 electrical engineer knows he should set up a target  
26 computer which is based on considerable extrapolation  
27 of previous trajectory; if the statistical properties  
28 to be expected of the airplane are quite different --  
29 for example involving almost completely random and  
30 unpredictable movements -- the optimal servo-mechanism







1 should be a much more sluggish one. So, few a priori  
2 rules can be stipulated in advance and certainly none  
3 by those who profess to be nihilistic about man's  
4 ability to forecast at all. We must get the best  
5 guidance possible from experience itself; and I'm  
6 quite sure that economic historians will feel that  
7 the Federal Reserve system was not premature in  
8 taking anticipatory action to ease the money market  
9 in the Spring of 1960, which was prior to the May  
10 turning point and which definitely involved looking  
11 over hills and not waiting to find out exactly which  
12 way the wind was blowing in order to lean against it.  
13 It is precisely the consideration that optimal  
14 stabilization policy must vary with the probability  
15 pattern to be expected from the system that needs to  
16 be stabilized which makes it rather ridiculous to  
17 specify in advance and for all times that some par-  
18 ticular gadget like three-per-cent-money-increase-  
19 per-year should be adhered to in season and out of  
20 season. Were the cold war suddenly to end imagine  
21 the avoidable evil consequences that would follow  
22 from such a predetermined policy.

23 II. Goals and Functions of Central Banking  
24 and Monetary Policy.

25  
26 12. Evolution away from profit motive. Anyone  
27 who has studied carefully the evolution of Central  
28 Banking will have noted the steady broadening of its  
29 functions and goals. In the beginning most central  
30 banks were hardly distinguishable from a commercial





1 bank, being first among equals and merely endowed  
2 with certain special privileges and duties. Long-run  
3 profit maximization was their proper criterion of  
4 action. Gradually the profit motive became subord-  
5 inate, and today it should be of no consequence at  
6 all. (The various money creation privileges given  
7 by the government to the central bank usually have  
8 implied more than enough profits anyway; and in a  
9 modern economy the accumulated earnings beyond a  
10 nominal minimum must be thought of as reverting,  
11 eventually or continuously, to the government --  
12 and note that I did not write the Treasury since  
13 that is merely an administrative subdivision.)  
14 Profit maximizing is at least a definite task and  
15 its disappearance makes the job of decision-making  
16 all the more ambiguous and difficult.

17  
18 13. Multiplicity of goals. After central banks  
19 had been recognized as quasi-public institutions,  
20 there continued to be an evolutionary broadening of  
21 their functions and goals. And I ought to say at the  
22 beginning that these purely factual trends are  
23 regarded by most economic experts as desirable  
24 developments. The same cannot always be said about  
25 the attitude of bankers. And even central bankers  
26 are not to be regarded as reliable authorities on the  
27 proper role of the modern central bank. Governor  
28 Strong of the New York Federal Reserve Bank and  
29 Montagu Norman of the Bank of England agreed on many  
30 things; from beyond the grave they undoubtedly would







1 disapprove of most changes in central banking which  
2 are not even matters of controversy today. If Canada  
3 appoints another Royal Commission to look into this  
4 matter 25 years from now, the witnesses before it  
5 will take for granted many changes that would shock  
6 the present generation of central bankers. I  
7 suspect that the direction of many such changes can  
8 be fairly confidently predicted today. I should add  
9 that these developments impress me as being for the  
10 most part salutary moves in the battle to improve  
11 the performance of non-totalitarian mixed-enterprise  
12 systems. Nor are they unique to central banking and  
13 monetary policy. If it were once true -- and the  
14 evidence for this is remarkably skimpy -- that  
15 taxation was never properly to be used for any purpose  
16 other than the raising of revenue, one has only to  
17 look around at the modern world to realize how  
18 untrue this is now and how much would be sacrificed  
19 in an attempt to revert back to some hypothetical  
20 earlier regime. I should also emphasize that many  
21 of the paths of future development are not easily  
22 foreseen now, and that the evolutionary process does  
23 not move smoothly toward any inevitable goal of  
24 perfection. We proceed by trial and error and many  
25 entrenched developments can be looked upon as grave  
26 mistakes from the standpoint of social efficiency.

27  
28 14. The primary goals of best utilization of  
29 resources on the outputs that are best distributed  
30 among people at each time and among present and future  
uses. Monetary policy, both as handled by the central



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1 bank itself and by the Government, does not have  
2 different ultimate goals from fiscal or any other  
3 social policy involving economic aggregates. Thus  
4 fiscal policy should aim at the proper degree of price  
5 stability in comparison with other major goals just  
6 as much as should monetary policy. And debt management,  
7 if it happens to be in the hands of the Treasury,  
8 should no more aim at unduly low interest rates, in  
9 order to cater to the vanity of the ruling Chancellor  
10 or in order to keep down unduly the tax burden of  
11 servicing the debt, than should central bank policies.

12 It is amazing how such a simple truth should be lost  
13 sight of in the usual discussions of these matters,  
14 including I make bold to say, some of the testimony  
15 offered you by eminent witnesses. I consider myself  
16 the simple child of the Hans Christian Anderson fairy  
17 tale who blurted out the secret that the King was  
18 wearing no garments at all, fine or otherwise. In  
19 a properly running democracy of the modern mixed-  
20 enterprise kind, the ultimate goals of macroeconomics  
21 are simply

22 (i) that there be best utilization of resources,  
23 in the sense of no chronic pools of human and  
24 property resources that are involuntarily out of  
25 work for reasons connected with the level of total  
26 dollar spending, and

27 (ii) that these resources be efficiently combined  
28 at producing the kinds of goods that the various  
29 citizens really want and need (which rules out as  
30 optimal various made-work activity like building

It is known that the  $\alpha$ -phase of the polymer is more stable than the  $\beta$ -phase, and the  $\beta$ -phase is more stable than the  $\gamma$ -phase.



1 unattractive pyramids or digging holes to be  
2 later refilled...), and  
3 (iii) that there be what society, within the frame-  
4 work of its agreed-upon system of property rights,  
5 deems to be an appropriate division of command over  
6 resources among different age and social classes  
7 (which means that society is to have the minimum  
8 standards of life provided for various people in  
9 accordance with its constitutionally-expressed  
10 decisions), and  
11 (iv) that there be the appropriate allocations  
12 of current resources between production of goods  
13 for present consumption as against goods that  
14 involve capital formation and widen the opportunities  
15 for future consumption.

16 All these decisions are made by the people of the  
17 democracy both in their individual capacities as  
18 spenders of their personal incomes on consumption  
19 goods and saving instruments and as spenders of  
20 various business funds as owners or agents of owners  
21 of property, and in their citizenry capacities as  
22 electors of responsible representative government  
23 to take care of the cooperative and coordinating  
24 functions of economic life and any welfare activities  
25 of responsible representative government. It is of  
26 course not the function of the Governor of the central  
27 bank to impose his own or any one else's opinions  
28 on society, any more than it is the function of the  
29 Under-secretary of the Treasury or the Secretary or  
30 the Budget Bureau Director or the Chief Executive





and the following provisions are hereby approved:

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1 or particular Members of Parliament to do so. But  
2 since it is a fact of life, quite unavoidable, that  
3 the way central banking and fiscal policy interact  
4 has substantive effects on unemployment and the  
5 distribution of income among persons and among present  
6 and future time periods, it follows inescapably that  
7 such considerations as these must have an appropriate  
8 role in the decision-making of monetary policy as  
9 well as fiscal policy.

10 15. The vital distinction between means and ends.

11 What about the important goal of "price stability?"  
12 What about "exchange rate stability?" What about  
13 economic growth? Of course such problems are not  
14 overlooked. But it is useful to point out that we  
15 want price stability because that may be necessary to  
16 keep the aged from being cheated by inflation, or may  
17 be necessary to permit efficient business planning  
18 and long-term contract formation, or may be necessary  
19 to avoid unsettling exchange rate depreciations,  
20 and so forth. Put this way, we do not prejudge the  
21 question of just what sacrifices have to be made in  
22 order to achieve this or that degree of price stability,  
23 or even this or that degree of secular price decline  
24 or rise. I shall say a great deal more about the  
25 problem of price stability, and a little bit about  
26 the merits for a country like Canada of various  
27 foreign exchange rate policies. I need only here  
28 mention that the problem of growth has already been  
29 included in my statement of primary goals or  
30







objectives, since the formulation in the previous section included the problem of achieving the desired allocation of goods between present and future. Since money and credit policies, almost by definition, involve decisions about interest rates and capital availability, which are the key terms of trade between present and future goods, one would have thought that out of any 10 witnesses before a Royal Commission on Money and Finance, almost all would have given a pivotal role to the central bank in helping a democratic society achieve its best feasible growth rate. Yet it is an empirical fact that many central bankers would, at first inquiry, be inclined to deny that growth was at all within their province of preoccupation. It will be clear that I, along with a great number of modern economists, am unable to concur in this view.

16. Monetary policy and stocks as against fiscal policy and flows. "Surely everybody cannot worry about everything and there must be some division of labor in a pluralistic society between various public agencies. If the central and monetary policy tries to do everything, it may end up accomplishing nothing. Whereas if it sticks to a narrow category objectives it will end up contributing, along with other agencies in the division of labor that characterizes modern society, its maximum to the broad objectives of society." Something like this will be argued against my previous remarks, and more still. "What after all is the distinction between monetary policy and any other kind of policy?"



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ALLEGEDLY, AFTER THE DESTRUCTION OF THE BUILDING



1 The answer to this must be given, and after it has been  
2 it will be recognized that it is outside the field of  
3 central banking and monetary policy that most of these  
4 broad social objectives must be realized." These are  
5 all legitimate questions and I now propose to give a  
6 tentative answer to the last one. Monetary policy  
7 differs from fiscal policy in that it is primarily  
8 concentrated with stocks of assets -- like cash, or  
9 short-term bonds, or long-term bonds, or borrowings,  
10 or various near-moneys and less-liquid net worth items;  
11 whereas fiscal policy is more involved with current  
12 flows of income -- like tax receipts levied against  
13 current income and sales or like current resource-  
14 using government expenditures or current welfare-  
15 transfer government expenditures. This contrast  
16 between stocks and flows as the key element in defining  
17 the realm of monetary policy will help to make clear  
18 why President Holtrop of the Netherlands Bank insisted  
19 in his Testimony before you that whenever debt manage-  
20 ment is being conducted by the Treasury rather than the  
21 central bank, one must recognize that an essential  
22 part of monetary (or just as accurately, asset) policy  
23 is being controlled outside the central bank. Thus,  
24 monetary policy is not that which central banks do and  
25 ought to do; nor is what central banks do and ought to  
26 do, monetary policy. Monetary policy is asset policy  
27 wherever it takes place, and in various times and  
28 institutional set-ups will be divided in various ways  
29 by organization. One can even imagine and observe,  
30 if not recommend, institutional cases where more than







1 one agency in a country has been exercising central  
2 banking functions. And I fear that adherence by those  
3 individuals who have been historically identified as  
4 central bankers to a narrow definition of their  
5 function will simply cause there to grow up elsewhere  
6 in society just those activities which they deplore.  
7 Before giving an opinion about the useful relationship  
8 between central bank and government, I want first to  
9 give a caricature of certain views about what  
10 constitutes central banking. While this is avowedly  
11 a caricature it cuts too close to the bone for comfort.

12 12. A caricature of what a central bank should be.

13 Against the above viewpoints, here is another. The  
14 job of a central bank is to guard the stability of  
15 the price level. It controls money and every school  
16 boy knows that money is what determines price levels.  
17 It never interferes with or affects relative prices  
18 or the sectors in which activity takes place. It  
19 leaves all that to the free market place: for the  
20 reason that a belief in freedom requires this; and for  
21 the reason that this is a more efficient way for  
22 society to organize itself. Democracy, and government  
23 generally, is always biassed in the direction of  
24 producing inflation. This is the great evil against  
25 which the central bank must always take guard. Because  
26 democracy can never be trusted, the central bank must  
27 be set up as an insulated non-political bastion of  
28 price stability, responsible to no one in the  
29 community but only to its function. It must therefore  
30







1 issue public statements of warning against public  
2 excesses. It must refuse to finance government  
3 deficits, and particularly must never finance them by  
4 issue of notes or by purchase of short-term floating  
5 debt. It should rarely even take on the long-term debt  
6 of the government. When a particular gang in office  
7 are behaving particularly badly from the standpoint  
8 of fiscal soundness, it is the duty of the central bank  
9 to contrive or help a flight away from the currency,  
10 calling upon central bank cousins abroad who act  
11 according to the motto approved by Professor T. Gregory,  
12 "Who hurts one, hurts all." It is a lonely and un-  
13 popular life, redeemed only by a good cuisine and a  
14 sense of righteousness at a distasteful task performed  
15 well. Secrecy is all important. The wisdom of private  
16 bankers, who understand these issues and are less  
17 inflationary minded than the community generally,  
18 should constantly be sought. Balance of payments  
19 problems, which domestic wastrels look upon as a  
20 necessary evil, the central banker regards as a  
21 blessing not in disguise: it enforces the discipline  
22 so shockingly absent in these parlous times. Career  
23 men, who begin life not overly burdened with academic  
24 knowledge, make the best successors to similar chiefs;  
25 but a few sound academics are useful too, not for  
26 helping to run day-to-day affairs -- since outside  
27 help for that is to be found in men who know and make  
28 their money from the money market -- so much as for  
29 providing general ideological defenses for the  
30 beneficent institution. Central bank employees are





1 like ballerinas who must practise each day; you must  
2 never let them go off on tours of duty in other branches  
3 -- scratch out the word "other" -- of the government,  
4 for that will blunt their abilities. Moreover, they  
5 are pure-bred ballerinas and you must not introduce into  
6 the central bank barnyard outside government officials,  
7 even on temporary tours of duty, for their contact with  
8 the ballerinas may involve a certain contamination that  
9 will be detrimental to proper performance. There is no  
10 point in prolonging such a cruel caricature. Like  
11 most caricatures it does serve the purpose of portraying  
12 in an exaggerated way some not uncommon attitudes.  
13 Moreover, although I have called it cruel, there are  
14 some writers, fewer today than in the past, who would  
15 claim literally that a central bank ought to be  
16 secretive and lean over backward as the only watch  
17 dog of the stability of prices in a world where all  
18 other interests seem biassed toward inflation. A more  
19 moderate and defensible position would frankly assert  
20 that the monetary authorities should overstate their  
21 case so that in an adversary procedure a better balance  
22 between inflation and deflation would be achieved.  
23 I think it interesting for example that President  
24 Holtrop in his testimony attached prime importance  
25 to the stability of the internal and external value  
26 of the currency. And Lord Cobbold, in his image of  
27 the automobile, instinctively thought of the central  
28 banker as the one who kept his foot on the brake while  
29 others pumped against the accelerator. On an a priori  
30 basis a lack of coordination between the government







1 and the bank could involve an interchange of positions  
2 half the time; but that is not the way things seem to  
3 modern central bankers. (Later in discussing growth  
4 I shall have to make the point that this kind of lack  
5 of coordination between central bank and government is  
6 a powerful drag on growth because it uses a lessening  
7 of capital formation as the offset to overspending on  
8 private and collective consumption.)

9  
10 18. The optimal long-term pattern for prices. There  
11 are three interesting possibilities for the trend of  
12 average prices: steadily and slowly downward; steadily  
13 and slowly upward; essentially level. Which of these  
14 three patterns is best? This is a difficult and  
15 perhaps even meaningless question to ask if nothing  
16 is specified about the uncertainties and errors of  
17 foresight that are supposed to accompany each pattern.  
18 However, certain normative evaluations can be made if  
19 we are willing to consider the rigorously abstract  
20 model where uncertainties and errors of foresight are  
21 absent. I fear that an unwary reader of the testimony  
22 presented to you by my long-time friend Sir Dennis  
23 Robertson may form an incorrect opinion on this subject.  
24 If I understand Sir Dennis he argues that, feasibility  
25 aside, it is a more proper pattern to have prices  
26 slowly falling with the increase in technological  
27 productivity so that the fruits of technological  
28 progress are distributed even-handedly among workers,  
29 property owners, retired persons, and so forth.  
30 Feasibility aside, is this a correct finding of economic







1 theory as was argued by many economists in the 1930's?  
2 I think not. A world in which there is and has been  
3 and will always be a positive exponential rate of rise  
4 in absolute prices would have exactly the same real  
5 allocations among labor and non-labor factors of produc-  
6 tion and among young and old as would a world with a  
7 foreseeable exponential fall in prices, or a world with  
8 stable prices. Indeed as Thornton, Marshall, Wicksell,  
9 Fisher, and others have argued there tends to get  
10 built into the money rate of interest a full allowance  
11 for the foreseeable change in price levels; and my  
12 study of the interest rates that insurance companies  
13 and others pay on fixed-money contracts suggests to  
14 me that something like this has already happened in  
15 some degree in America and abroad. I conclude from  
16 this that there is no presumption in the purest  
17 theoretical model in favor of the view that a slowly-  
18 declining price level is optimal.

19 a. The criterion that the ideal situation is that  
20 which would correspond best to an idealized state  
21 of barter, where money has no so-called distorting  
22 effects and is allegedly "neutral," strikes me as  
23 a rather gratuitous criterion. It completely  
24 ignores the fact that one has to have an agreed-  
25 upon social welfare function that adjudicates the  
26 deservingness of those who gain from price change  
27 before any real normative statements can be made.  
28 But sticking to that criterion, I hope I have  
29 shown that within the abstract model involving  
30 no rigidities and uncertainties, the Robertson





1 presumption in favor of declining prices has no  
2 particular validity, since a golden age with price  
3 stability or steady price rise leads to no worse  
4 results.

5 b. But I must not put words in Professor  
6 Robertson's mouth. He no doubt had in mind a  
7 world with a reasonable degree of uncertainty.  
8 Once any appreciable elements of uncertainty  
9 are in the picture it is remarkably hard to make  
10 normative statements at all: we pass this way  
11 only once, the Bible says, and even a lunatic  
12 can say, "If you believed what I believed was  
13 going to happen, and feared what I feared was  
14 going to happen, you would have to admit that it  
15 was not irrational of me to wear knight's armour  
16 to the factory."

17 But let us be pragmatic in good English fashion and  
18 try to form normative judgments. Professor  
19 Robertson, as I understand it, has not said  
20 that in principle falling prices are good  
21 because that happens to splash his cautious  
22 friends with extra real goods; because to that  
23 you could answer that rising prices are good  
24 because that splashes your deserving risk-  
25 taking friends with real goods. His attempt  
26 to set up as in some sense approximately good  
27 the condition that would tend to prevail if  
28 money were "neutral" and did not distort natural  
29 barter arrangements would at bottom I suppose  
30 reflect the rough notion that interpersonal





presented in favor of declining prices has no

substantial basis, and a similar view with respect

to the effect of steady prices also leads to no worse

conclusion.

It is a fact that the price of wheat is

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1 equity aside, a situation free from price-level  
2 distortions is more likely to be efficient in  
3 the technical sense of "Pareto-optimality."  
4 Now it has come to be conceded pretty much  
5 everywhere that there is no guidance to choosing  
6 generally between feasible situations to be found  
7 in concentrating only on Pareto-optimality  
8 properties of alternative situations. But is it  
9 true that balanced falling prices with the dollar  
10 buying more as technology improves brings a greater  
11 degree of Pareto-optimality than would stable  
12 prices or slowly balanced price rises? To the  
13 extent that foresight prevails, the answer is  
14 obviously no. To the extent that there are  
15 errors of foresight, no one that I can recall  
16 has demonstrated a presumption of greater Pareto-  
17 optimality in gentle secular deflation as compared  
18 to steady price levels, or for that matter gently  
19 rising price levels. Unless I have overlooked  
20 something, some new types of argumentation would  
21 have to be supplied before one could draw any  
22 such conclusion.

23 19. What price stable prices? Abstract models  
24 having established no presumptions, we must turn to  
25 feasibility conditions. Here, fortunately, there can  
26 be a general agreement. Given the institutional  
27 rigidities of a modern economic system, most experts  
28 agree that the attempt to shape fiscal and monetary  
29 policy to produce a trend of declining prices will  
30

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1 have grave consequences for total unemployment and  
2 production growth. At best (or worst), it is argued  
3 society should want to aim for steady prices. As  
4 the American Commission on Money and Credit has  
5 concluded, this involves the difficult choice of which  
6 index to stabilize: wholesale prices, consumer prices  
7 (or the so-called cost of living), or the Gross  
8 National Product deflator? Stabilizing wholesale  
9 prices would entail in the modern world a rise in the  
10 consumer price index of more than one per cent per  
11 year in the long run, for the reason that there is  
12 slower productivity gain (as the statistician ...  
13 measures it) in the services sectors of the economy  
14 than in the goods sectors. A still greater rise in the  
15 GNP Deflator would seem probable. The Commission on  
16 Money and Credit also pointed out that recent  
17 researches have suggested that official index numbers  
18 are almost necessarily biased upward in that they  
19 fail to make appropriate allowances for quality  
20 improvements: if the official Consumer Price Index is  
21 reported to rise at one per cent per year, the error  
22 here involved suggests that a dollar is probably  
23 just about holding its own in terms of true purchasing  
24 power as measured by the utility of goods it will buy.  
25 A small economy that is open to the rest of the world  
26 must have a price trend pretty much set for it from  
27 abroad if it insists on fixed foreign exchange rates.  
28 If world price indexes could be held to a long-term  
29 rate of increase that averaged out over buoyant and  
30 dull epochs to not much more than one per cent, there





1 would still be the problem that certain elements in the  
2 community - particularly in the lower income classes -  
3 will find that the savings they set aside for retire-  
4 ment in the future are likely to show a diminution of  
5 real yield. With higher rates of price increase this  
6 problem becomes still worse. Since statistical  
7 researches suggest that the principal victims of mild  
8 inflations are the old as against the young, there is  
9 a strong case for helping these groups adjust to the  
10 problem. This might involve: (i) purchasing-power  
11 bonds, annuities, saving accounts, and equity funds  
12 being made available to people on favourable terms  
13 by government aid, but in limited amounts; (ii) more  
14 pay-as-you-go private pensions; and finally, (iii)  
15 what is already a universal fact of modern life,  
16 social security benefits that keep up with the taxable  
17 capacity of the nation and with the price level. Such  
18 measures need not weaken the fight against undesirable  
19 inflation. Nor is it true that the "purpose" of the  
20 inflations we have to fear is precisely the cheating  
21 of the old, so that sliding-scale adjustments in  
22 their favor will only speed up the rate of demand  
23 inflation to accomplish again this purpose. The  
24 inflation dangers ahead are more likely to be of the  
25 "cost-push" or "sellers'" type, or of the cataclysm  
26 type that come in the wake of war and social dis-  
27 organization.

28 20. Incompatibility of objectives. It would be  
29 nice if modern mixed societies would have the friction-  
30 less price flexibility to permit us always to have







1 price stability without jeopardy to sustainable growth  
2 and efficient employment at high levels. It would  
3 also be nice if motors turned with less friction and  
4 if TV sets could grow like weeds. The facts of life,  
5 alas, are not all ideal; and while they are mutable,  
6 it is one of the facts of life that they cannot be  
7 changed in the easy way men might wish. As evidence  
8 accumulates, suspicion mounts that there will arise  
9 many occasions when society will find a clash between  
10 approximate price stability and tolerable sustained  
11 high employment and growth. I know that some experts  
12 deny this: in my files I have a number of such  
13 denials by eminent bankers and scholars. I wish that  
14 they were more convincing, because life would be  
15 better if there were no "trade-offs" between objectives  
16 and no need to compromise between evils. The  
17 Commission on Money and Credit ended up worried by  
18 this problem; and it is my guess that even their  
19 Report is too optimistic. This is not an issue that  
20 can be decided by reason or be decided on the basis of  
21 past experience. Nor is there a need to come to a  
22 firm decision before the fact. Yet it is essential  
23 to have one's thinking alerted to the problem and to  
24 prepare tentative strategies for handling events  
25 as they materialize. Now precisely because it is  
26 economically false that monetary policy has some  
27 special potency to affect the P in  $P \times Q$ , I must assert  
28 boldly: The problem of determining how much price  
29 rise will be tolerated in the interest of a longer  
30 and growing output and employment is every bit as







1 much a problem for fiscal policy as it is for monetary  
2 policy. There is no reason in logic or ethics why  
3 the central bank should be the agency for pulling the  
4 compromise in one direction -- say, the dis-inflationary  
5 direction -- rather than the government (be it Parliament,  
6 the Executive, or the Treasury). Indeed non-elected  
7 officials who hold long-term office and who are  
8 permitted wide freedom in their actions are not at all  
9 the ones in a responsible democracy to resolve these  
10 problems. This does not deny that the people through  
11 their legislature may choose to set up a quasi-  
12 independent agency to represent them in this regard.  
13 Except by the Darwinian test of survival of certain  
14 older central bank attitudes, there seems to be  
15 little evidence that the people have chosen to make  
16 such a social compact. It is in this sense that every  
17 central bank is responsible to government and not  
18 really independent.

### 19 20 III. Conclusion

21 21. Miscellaneous items. This testimony is  
22 already long. Yet I have barely scratched the surface  
23 of many relevant issues. Since time will not permit  
24 discussion of them in the depth they deserve, I shall  
25 simply list a number of opinions that could be  
26 elaborated on in oral testimony or at some later date.

27 1. A country like Canada might gain a good deal  
28 from a system of flexible exchange rates, in contrast  
29 to the stable exchange rates of some large powers like  
30 the United States.



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### III. Conclusion

Mr. [Name]. This testimony is

already done. Yes I have merely reviewed the entire

of many relevant issues. Since time will not permit

discussion of them in the depth they deserve. I shall

simply list a number of opinions that could be

elaborated on in oral testimony or at some later date.

1. A country like Canada might gain a good deal

from a system of flexible exchange rates, in contrast

to the fixed exchange rates of the Bretton Woods

system.



2. While open-market operations and required reserve requirements are the important tools of conventional central banking, the earlier Canadian experiment with a discount rate that changed rather flexibly with respect to market bill rates has much to recommend it. The limited advantages of having something dramatic to announce when a change in market conditions is desired might still be preserved by having certain special differentials decreed at such times.

3. The goal of faster growth can be achieved in a mixed-enterprise economy, if at all, primarily by one mechanism -- namely, by conventional and unconventional monetary policies designed to stimulate a long-term deepening of capital, with the corresponding reduction of the proportion of consumption as a fraction of full-employment product being achieved by a compensatingly tight fiscal policy that prevents demand-pull inflation. This means that money cannot by its nature be "neutral" and hence the notion that central banking can be over and beyond responsible political decision making is quite untenable.

4. Every modern central bank should be made clearly responsible to the democratic government in power. This does not mean making it a mere branch of the Treasury. Nor does it require short terms of office for central bankers. Nor does it deprive the governor of the central bank of his freedom in day-to-day operations. Nor does it rob him of his power to nag publicly and privately. Nor does it take away





5. While open-market operations and monetary

policy remain as the important tools of

monetary control, the Federal Reserve

agrees with a "rule of thumb" which states

that the money supply should grow at the

same rate as the economy. The Federal Reserve

is committed to a program of growth in

the money supply at a rate which is equal to

the rate of growth of the economy.

6. The goal of monetary policy is to

maintain the economy at a level of

employment which is consistent with the

long-run growth of the economy. The Federal

Reserve is committed to a program of growth in

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committed to a program of growth in the

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1 from his ultimate weapon -- dramatic resignation in  
2 public protest against what he deems to be bad policy.  
3 But it does mean that, after due process and agreed-  
4 upon delay periods, he must either yield to govern-  
5 mental policy or be subject to removal from office.  
6 There is no room in a modern democracy for a Fifth  
7 Estate, which serves as an insulated pocket of power  
8 set up to accomplish its own purposes be they good  
9 or be they bad. Freedom of a democracy to make its  
10 own mistakes is not merely a desideratum: it is an  
11 inevitability.





# Royal Commission on Banking and Finance

DR. A.K. EATON.  
THE CANADIAN CHAMBER OF COMMERCE.

Hearings  
held at

OTTAWA

Vol.

51

Date.

23 OCT 1962



Official Reporters  
J.J. Pethercut and R.J. Young  
Toronto, Ont.





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Toronto, Ontario

I N D E X

Page No.

DR. A.K. EATON

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THE CANADIAN CHAMBER OF COMMERCE

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,  
Ontario, on Tuesday,  
October 23rd, 1962.

THE COMMISSION

The Honourable Dana Harris Porter  
Chief Justice of Ontario  
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.  
Investment Dealer  
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.  
Banker  
Toronto, Ontario

Mr. Gordon L. Harrold  
Agriculturalist  
Calgary, Alberta

Mr. Paul H. Leman  
Corporation Executive  
Montreal, Quebec

\* Mr. John C. MacKeen  
Corporation Executive  
Halifax, Nova Scotia

\* Dr. W.A. Mackintosh,  
Vice-Chancellor  
Queen's University  
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

\* Absent (Commissioner MacKeen present  
during afternoon session.)



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Ottawa, Ontario,  
Tuesday,  
October 23rd, 1962.

--- On resuming at 9.15 A.M.

SUBMISSION OF

DR. A.K. EATON

THE CHAIRMAN: Dr. Eaton, it is a pleasure  
to see you again.

DR. EATON: Thank you, sir.

THE CHAIRMAN: We will proceed with  
discussion of your paper on your analytical comment  
on the Canadian tax structure. Have you any  
preliminary remarks you wish to make?

DR. EATON: No sir, I think I have none.

THE CHAIRMAN: We will then proceed with  
the discussion.

DR. EATON: Yes, sir.

COMMISSIONER BROWN: Mr. Chairman, I suppose  
before we start discussing the tax structure we should  
make it clear that as far as this Commission is  
concerned we do not want to get into fields that  
more properly belong with the Royal Commission on  
Taxation. However, at the risk of that, I think we  
would like to discuss the effects of taxation on  
capital flows and capital accumulation. I would like  
to start by referring to paragraph 27 of your brief  
in which you refer to the fact that a large part  
of income from investment of savings is not subject

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1 to income tax. That is through house ownership,  
2 pension funds, insurance policies, and you also refer  
3 to a certain number of bond coupons that are cashed  
4 without being subject to taxation.

5 DR. EATON: That is right.

6 COMMISSIONER BROWN: What I want to ask you  
7 is whether, in your opinion, this form of accumulation  
8 tends to over-emphasize the conservative type of  
9 investment and reduce the amount that would be  
10 going more directly into equities?

11 DR. EATON: Well, I would say generally  
12 that it does through the very nature of the part that  
13 these savings play. Take the insurance companies:  
14 their general policy is to match debt with debt.  
15 Now, at least, they are broadening out a little in  
16 their equities; but generally I would say the insurance  
17 money does go into debt. Pension people, generally,  
18 certainly much more so in this country than in the  
19 United States, will have the bulk of their funds in  
20 debt securities. Some of the larger funds in the  
21 United States come almost close to half in equities.  
22 I think General Motors is up around 38 per cent or 40  
23 per cent in equities. Certainly in the annuities,  
24 government annuities particularly, I would say generally  
25 these items I have listed are mainly in debt rather  
26 than equity capital, or over in the debenture capital  
27 field, and I think it is too bad; I would like to  
28 see more of it spread out into equities, but I don't  
29 know quite what you can do about it. You can legislate  
30 them into that, but it is a pretty risky thing for a





to know that the thing is not possible.

question (about insurance policies, and you also refer

to a certain number of good couples that are capable

of doing things that are not possible.

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1 government to push funds or urge funds over into more  
2 risky investments. Generally, I think it is a fair  
3 generalization that you have made about the direction.  
4 I don't think that is mainly because they are tax-  
5 exempt through this period. I think it is more the  
6 actual flow than the policy of people who are managing  
7 these funds. I don't think there is more investment,  
8 say, in government bonds merely because quite a package  
9 of it escapes tax. I have seen people cashing their  
10 coupons in small pieces in different banks so they  
11 will not have a large enough sum in one lump to have  
12 to be reported through ownership certificates. There  
13 is quite a bit of that.

14 COMMISSIONER LEMAN: You did not get them  
15 arrested?

16 DR. EATON: Well, the banks are not inclined  
17 to cast too particular an eye on offending people in  
18 these directions.

19 COMMISSIONER BROWN: The next point I wish  
20 to ask you about is in reference to paragraph 31 where  
21 you comment that if the personal income tax rates  
22 above 50 per cent were cut off -- in other words,  
23 reduced to 50 per cent, the tax cost would be less  
24 than \$10 million; and further, if it was a 40 per  
25 cent ceiling it would cost \$40 million. I wasn't quite  
26 sure what you were getting at there. Is it that this  
27 change would not cost the government very much, or  
28 would not produce very much money available for invest-  
29 ment?

30 DR. EATON: What I mean there mainly is that







1 these high rates are not very necessary, although,  
2 after having said that, you can say that if you  
3 reduce them you would not have freed much additional  
4 capital for investment. That is the disappointing  
5 part of it. It is quite another story if you brought  
6 it down to the flat rate of 16 per cent, which I  
7 have commented on -- that that would produce the same  
8 revenue -- and you would get something of the order  
9 of 200 million a year freed through dropping the  
10 rate to 16 and bringing the others up to 16. There  
11 would be a couple of hundred million more money  
12 available for investment, with people paying 16 where  
13 they now pay up to 20 or 25. I think I am suggesting  
14 here that this would make good sense, and partly it is  
15 not entirely the amount of revenue. I think an awful  
16 lot of people just plain resent those rates and do  
17 whatever they can to avoid it, and enter into all  
18 kinds of methods and techniques of avoiding them,  
19 and they are generally against income tax because of  
20 these high rates. I think that is bad, and I don't  
21 think it is necessary. I think these very high rates,  
22 certainly above 50, just do not make good sense from  
23 anybody's point of view -- except the socialists; they  
24 like that.

25 COMMISSIONER BROWN: But, in fact, at these  
26 levels it would not produce too much available for  
27 investment?

28 DR. EATON: No, no; I agree with that entirely.  
29 It is amazing the smallness of the amount of revenue  
30 you get through the high rates, and it was this general



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1 fact which was revealed so clearly in the years when  
2 we had the investment income tax right across the  
3 board. We were just getting peanuts out of it. It  
4 is amazing the small amount of investment income  
5 there is in this country; that is, I suppose, that there  
6 hasn't been the opportunity to accumulate great wealth  
7 in the middle and upper income brackets. We are just  
8 a poor country, and this sort of thing just keeps on  
9 that way.

10 COMMISSIONER BROWN: You mean in the hands  
11 of individuals?

12 DR. EATON: Yes.

13 COMMISSIONER BROWN: On the question of  
14 corporations, I would like to get your comments on  
15 whether, in your opinion, the tax structure including  
16 the capital costs allowances perhaps over-encourage  
17 the retention of earnings and cash flow by corporations;  
18 in other words, what is your reaction to the proposition  
19 that has been expounded several times by Mr. Kierans  
20 of the Montreal Stock Exchange, that corporations should  
21 be encouraged to push out these retained earnings and  
22 let the market decide how corporation funds are  
23 invested?

24 DR. EATON: I have never really understood  
25 completely his analysis of this. No, I am not in  
26 favour of that. I think from the point of view of the  
27 country it is all to the good that earnings are retained  
28 instead of pushed back out and subject to such high  
29 personal income tax rates. I think it is a bit  
30 encouraging -- and it is just in its beginnings yet --





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*Nethercut & Young*

*Toronto, Ontario*

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1 the new businesses and other new shows that has been  
2 announced recently of using upstairs money for  
3 financing, not their own businesses, but new businesses  
4 outside. I am very encouraged to see that happen,  
5 and I think it is a good thing, rather than having the  
6 large grow larger and still be able to finance and  
7 take on as an outside form what the Industrial  
8 Development Bank is trying to do mainly through debt.  
9 I do not think they take equities at all; I think they  
10 can, but I don't think they do very much. So, rather  
11 than put all these smaller companies into debt, if  
12 these big shows with pots of money would get into an  
13 equity position with some of the smaller outfits,  
14 I think it would be all to the good. I would not like  
15 to see a piece of law to encourage the dispersal of  
16 more capital funds back into the public. As a matter of  
17 fact, I think the big shots in industry are better judges  
18 of where money should be put than the general public.  
19 This is old theory: we had this all through the New  
20 Deal stage in the United States. They came in at one  
21 stage with a tax on undistributed income purposely  
22 to encourage this sort of thing. It didn't last very  
23 long; I have forgotten whether it ever got on the  
24 statute books, but the New Deal crowd were imbued  
25 with this idea, and I don't go along with it.

26 COMMISSIONER BROWN: One of the arguments that  
27 has been advanced is the fact that -- and this is from  
28 D.B.S. figures -- that assets in manufacturing after  
29 depreciation in the ten years 1950 to 1959 grew from  
30 9.1 billion to 20.1 billion while profits increased only







1 from 1.3 billion to 1.57 billion, which is a return  
2 of only 2.4 per cent after tax. People have read  
3 into these figures that perhaps business has not been  
4 so smart in its expansion.

5 DR. EATON: I don't suppose I am too  
6 sophisticated in this. Let me give you an example:  
7 Mr. Capon of DuPont has got quite upset about this  
8 very question, and he wrote an article in the Financial  
9 Post recently, and he and I are going on a Tax  
10 Foundation programme on this very question. He feels  
11 much the same as Kierans does -- I don't know whether  
12 it is for the same reason -- but here is the Vice-  
13 President and Treasurer of DuPont, and he, looking  
14 particularly over the situation, thinks it would be a  
15 good idea if corporations were made to disperse  
16 practically of their earnings, and he is making a  
17 proposal to that effect. He has done so in print,  
18 and he is going to go on to the platform on the same  
19 issue. Perhaps I am not familiar enough with the  
20 inside workings to know whether they are over-investing.  
21 My impression is that I don't like the idea of forcing  
22 earnings out.

23 COMMISSIONER BROWN: Let us say if this could  
24 be done, and adjustments made so that the total tax  
25 take remained the same?

26 DR. EATON: Even so, I don't think so. I  
27 keep coming back to this question of trying to see  
28 industrial earnings free from too high personal income  
29 taxes. There is a lot of tax free gain in the hands  
30 of the individuals through the ploughing back of earnings.



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1 There is a big tax-free gain, if you like, made by  
2 the holders. This would not happen any more;  
3 if you are going to force out earnings, you won't  
4 have this growth factor in industry. Perhaps you  
5 say it is exaggerated and it is not paying off as  
6 high as it should, but to the extent you keep pushing  
7 all of these earnings back into the personal income  
8 tax ranges, I think it is bad.

9 COMMISSIONER BROWN: If my premise carried,  
10 and that is, if the total tax take remained the same --  
11 in other words, there was still the same amount of  
12 money over-all available for investment, but the  
13 individual shareholder had a greater opportunity to  
14 direct that investment?

15 DR. EATON: Well, you can say, "If the  
16 same total amount were available..." -- I doubt if  
17 it would find its way back. Perhaps I am sliding  
18 past your question here, but if it is available I  
19 don't think it would find its way back -- certainly  
20 with not as much certainty as now. That is, if you  
21 had this so that it was free, there would be more of  
22 a tendency to spend it in other directions rather than  
23 industry. I haven't any confidence that if you did  
24 push it up you would get anywhere near the same  
25 amount back for investment in industry.

26 You can counter that, and say, where it is  
27 being invested it is not being invested to the best  
28 advantage. That may be so; I can't really answer that,  
29 but I am always suspicious of these derivations from  
30 these total lump increases that are put out. I don't





There is a big question about it, and I don't want to

the subject. This really has nothing to do with

it you are going to force out earnings, you won't

have this question factor in industry. Perhaps you

may be in a position and it is not paying off in

high as it would, and to the extent of being profitable

all of these questions have been the subject of

the subject, I think it is true.

WOMAN: I think it is true. It is a question of

and that is, if the total cost of the industry is the same --

in other words, there was still the same amount of

money spent on the industry for investment, and so

industrial production and a number of opportunities to

invest in the industry?

MAN: Well, you are right. It is

the same amount of money spent on the industry, and I don't think

it would be a very big thing. Perhaps I am missing

that your question here, but it is possible that

you are right. It would be a very big thing -- certainly

after all we have been talking about. That is, if you

are able to get the same amount of money, there would be more of

a tendency to spend it in other directions rather than

industry. I haven't any confidence that it is the

same in the world for investment in the same

amount back for investment in industry.

You can compare that, and say, where it is

being invested is in not being invested in the best

advantage. That may be so; I can't really answer that.

But I am afraid that is the question of investment in

these total lump increases that are put out. I don't



1 question the Bureau of Statistics: it is just a  
2 derivation from totals that they have got.

3 COMMISSIONER BROWN: Let us look at the  
4 same thing from a slightly different angle: does the  
5 tax structure -- I am not thinking of income tax  
6 now so much as the fact that construction materials  
7 and machinery have certain exemptions from  
8 manufacturers' sales tax: does this sort of tax  
9 structure over-encourage business in investment as  
10 against consumer spending?

11 DR. EATON: I take this point of view, that  
12 this is, in fact, avoiding a pyramiding of tax.  
13 Certainly for this country it is vastly important that  
14 we not have a sales tax on the equipment for producing  
15 goods for export. If you had it on all machinery  
16 and equipment it would not be anything too tragic --  
17 if you had pyramiding of tax on equipment for domestic  
18 purposes, but it would be bad if you had it on equipment  
19 manufacturing goods for export. This is one of the  
20 things our businessmen are so confused about. They  
21 think there are incentives given in the European tax  
22 system which make it difficult for them to compete  
23 because they give exemption from their sales taxes  
24 and turn-over taxes in Europe, whereas, in fact,  
25 we have always done that. We have exempted the machinery,  
26 and equipment producing goods for export. When Europeans,  
27 with different types of systems, start doing that, we  
28 howl to the high heavens about it, whereas, in fact,  
29 we have never had that sort of thing in our system.  
30 I would not say that is a positive encouragement to more



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1 investment. It is just the removal of an obstacle  
2 which otherwise should not be there.

3 COMMISSIONER BROWN: These are all points  
4 that rather encourage the accumulation of capital  
5 and its use, are they not -- these several points  
6 we have been discussing; that is, the retention of  
7 earnings in corporations and these taxes as well?

8 DR. EATON: I don't know that I would say  
9 it is a positive encouragement. I certainly would  
10 not agree that the absence of a sales tax on machinery  
11 and equipment would be regarded as a positive incentive.  
12 I would say it is just the removal of what would  
13 otherwise be a positive obstacle. As for the retention  
14 of earnings, it is just a free country, and the  
15 directors decide what is fair to disperse and what  
16 is better to keep. I don't know whether I might come  
17 back on this same point, reverting to the point you  
18 made, that if the same volume of funds were available  
19 for investment wouldn't that be a better situation: I  
20 think no. Here I don't want to get too far on this,  
21 but today the incidence of that corporate tax, I  
22 believe, is mainly passed on to consumers. I would not  
23 like to see a large part of this shifted back -- shifting  
24 from consumers generally back on to the middle and  
25 upper group of income tax papers. I think this system  
26 of corporate tax is there and is passed on and that  
27 they are not compelled to disperse.



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1 I think that gives the best direction for the incidence  
2 of this tax, and the greatest prospect of getting more  
3 capital for investment.

4 COMMISSIONER BROWN: You have a section  
5 on the incidence of this tax.

6 DR. EATON: I did not mean to push into that,  
7 but it is another aspect.

8 COMMISSIONER BROWN: It is another aspect  
9 of the whole thing. I am not sure that the figure  
10 2.4 per cent after tax always bears out the over-all  
11 contention -- it is probably beyond our scope, and  
12 is the lot of another commission.

13 THE CHAIRMAN: Have any of the other  
14 Commissioners questions on this point?

15 COMMISSIONER LEMAN: Before we leave the  
16 section that Commissioner Brown was talking about,  
17 referring to your paragraph 42, Dr. Eaton, you make  
18 the point there that apparently the corporate tax  
19 system at its relatively high rate comparative to  
20 what people had been used to pre-war surprised every-  
21 body; there were a great number of people who had  
22 thought that this would slow things down a great  
23 deal, but it does not seem to have done that. What  
24 do you think about the length of test you are talking  
25 about there? Is it a long enough test? Are there  
26 circumstances during and after the war that make it  
27 appear that this high rate of tax has not hurt  
28 us, which would not necessarily be true over a longer  
29 period of time and in a completely different set of  
30 competitive circumstances.





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1. The first thing that strikes me is the fact that the  
2. of this tax, and the greatest prospect of getting more  
3. capital for investment.  
4. CONGRESSIONAL RECORD: Vol. 76, No. 1, p. 1.  
5. on the subject of this tax.  
6. Mr. FAY: I do not want to get into this  
7. but it is a very serious matter.  
8. CONGRESSIONAL RECORD: Vol. 76, No. 1, p. 1.  
9. of the whole thing. I am not sure that the House  
10. the part that often has a large share in the over-all  
11. connection -- it is a very serious matter, and  
12. is the last thing that should be done.  
13. THE CHAIRMAN: Have any of the other  
14. Congressmen questions on this point?  
15. CONGRESSIONAL RECORD: Vol. 76, No. 1, p. 1.  
16. section that has been passed and that is the  
17. report of the committee on the subject of this tax.  
18. one point that I should like to mention is the  
19. system of the relation of the tax to the  
20. what people have been doing in the past, and that is  
21. that there was a great deal of work done in the  
22. country that has been done in the past, and that is  
23. that, and it seems to me that it is a very serious  
24. to you think about the fact that you are talking  
25. about there is a big question here? And there  
26. circumstances that are going to make it  
27. appear that this is a very serious matter.  
28. as, which would not necessarily be true even a long  
29. period of time and in a completely different set of  
30. circumstances.



1 DR. EATON: Well, I don't know. Certainly  
2 we are at a time, both here and in the United States,  
3 where both countries are worried about their growth  
4 factor slowing down -- things are not growing as they  
5 should. This is what the classical economist says:  
6 Just you wait -- they won't be able to keep passing  
7 the tax on forever; when you get into tough competition  
8 you will find trouble absorbing the tax.

9 Well, it may happen -- I don't know. It  
10 does seem to be thoroughly into the industrial  
11 planning and price policy and so on, just to take  
12 the corporate tax as a cost, and say we have to  
13 recover this and this -- to look at the after-tax  
14 profits. I don't know whether that will work in.  
15 Perhaps there will be a few who will in effect absorb  
16 it and start cutting prices. But I don't look for  
17 it to happen on any great scale. I think there will  
18 just be a slowing down rather than a relief to the  
19 system through absorbing the tax. That, I think,  
20 will be the natural result.

21 Your suggestion was that the system  
22 of passing the tax on in higher prices would not  
23 always persist. Well, I am inclined to think it  
24 will.

25 COMMISSIONER LEMAN: What I am asking you  
26 about is your judgment of what a certain level of  
27 corporation taxation can do to an economy over a period  
28 when most of the time we are in what was considered  
29 a seller's market, and whether you might not change  
30 your opinion if during an equal period in length of time



DR. ALVIN KARP, 1000 17th Street, N.W., Washington, D.C.

We are at a time, both here and in the United States,

where we have a high unemployment rate and we are not getting any more

factor slowing down -- things are not moving, as they

should. This is what the classical economists say:

Just you wait -- they would be able to keep passing

the tax on foreign, when you get into such competition

you will find yourself increasing the tax.

Well, it has happened -- I don't know. It

has happened in the past, but it has happened

in the past and it has happened and it has happened

the economy has not moved, and they are not

moving it -- it is not moving it -- it is not moving it

moving it. I don't know whether it will work in

the future or not, but I don't know whether it will

be and what is going on -- but I don't know for

it is based on the fact that I think there will

be a steady increase in the rate of the

system through the rate of the rate, I think.

will be the same, I think.

What is going on with the system

of passing the tax on to the private sector would not

always be the case. Well, I am inclined to think it

will

COMMISSIONER DEMAN: What I am asking you

about is your judgment of what a realistic level of

corporate taxation can be in an economy over a period

when most of the time we are in what was considered

a seller's market, and whether you might not change

your opinion if during an equal period in length of time





1 you were in a buyer's market.

2 DR. EATON: I don't know. It might shade  
3 off; perhaps a lesser amount would be passed on in  
4 higher prices. However, I cannot see it happening  
5 as a general rule, that profits will absorb the full  
6 amount of this 50 per cent corporate tax. Somehow,  
7 I just can't see it happening.

8 COMMISSIONER GIBSON: You see, Dr. Eaton,  
9 the normal difference is between industries in their  
10 abilities to pass the tax on. Let us take two extremes:  
11 you mentioned utilities, where there is a great deal  
12 of evidence of the tax being passed on. The other  
13 extreme is, let us say, some industry like the needle-  
14 work trade, relatively small units, and with a great  
15 deal of competition. Do you think it will be successful  
16 in passing the tax on?

17 DR. EATON: Well, if you get down to the  
18 smaller companies, they only have 21 per cent tax  
19 as compared to 50 per cent. It may not be so obvious.

20 Now, I think I will have to agree that where  
21 the competitive situation is very tough, there will  
22 always be some who are unable to pass on the tax.  
23 But within a fairly wide range there will be a group  
24 who operate efficiently enough to meet the market and  
25 pass it on. There will be industries which have  
26 difficulty in passing it on, but I do not think that  
27 will be true of everyone.

28 COMMISSIONER GIBSON: We have heard quite a  
29 bit in the last three or four years about the problems  
30 of some of our domestic industries to meet the import



you were in a buyer's market.

MR. RAYMOND: I don't know. It might change.

old; perhaps a lesser amount would be passed on in  
higher prices. However, I cannot see it happening  
as a general rule, and policies will remain the full  
amount of this to pay some one else's tax. However,

I don't see it happening.

COMMISSIONER GIBSON: You don't know.

the normal difference in between industries in their  
abilities to pass the tax on. Let us take two extremes:  
you mentioned cigarettes. There is a great deal  
of ability of the tax to be passed on. The other  
extreme is for us say, some industry like the radio-  
wave industry, which is not able to pass a great  
deal of the tax on. In your opinion it will be successful  
in passing the tax on?

MR. RAYMOND: Well, if you pass down to the

retailer, especially if you have a lot of tax  
as compared to the cost of the goods, it may not be so obvious.  
But I think I would have no doubt where  
the competitive situation is very tight, there will  
always be some one who is able to pass on the tax.

Let us take a very tight market where there will be a group  
of operators sufficiently enough to meet the market and  
pass it on. There will be industries which have  
difficulty in passing it on, but I do not think that  
it will be true of everyone.

COMMISSIONER GIBSON: We have heard also a  
bit in the last three or four years about the problems  
of some of our domestic industries to meet the import



1 competition they face. That is what I am thinking of.

2 DR. EATON: I expect there will be cases  
3 where they will meet the import market, regardless  
4 of profit. The point is, we don't know enough about  
5 this whole question. I would like to see the  
6 Royal Commission on Taxation make a very definite  
7 study of this whole matter. I do not pretend to  
8 be too wise about it. I am just reporting here  
9 my experience in these things, and it is not very  
10 widely based. That seems to be the feeling of all  
11 of us who are sticking our necks out on this question.  
12 You need a lot more study on it.

13 The theory of what you can do to the tax  
14 system hinges very much on this very point; it is  
15 a most important one. Even with respect to the  
16 services industries, you asked me whether they could  
17 pass the corporate tax on. I don't know whether  
18 they do it or not. It is not just a question of  
19 selling things and marking them up. This is quite  
20 a complex situation, where you try to recover. There  
21 is a whole range of industries that I don't know about  
22 or haven't any views on. This is just through lack  
23 of knowledge.

24 COMMISSIONER BROWN: Is your general thesis  
25 based on the assumption that to the extent new capital  
26 is invested and has been invested since the tax rate  
27 of 50 per cent became standard, that tax rate is  
28 taken into consideration as a factor in determining  
29 whether the investment will be a good one or not?

30 DR. EATON: Yes, I think there is that con-





Investigating Your Case. This is what I am interested in.  
The Bureau of Land Management will be glad to

where they will meet the import market, regardless  
of profit. The point is, we don't know enough about  
this whole question. I would like to see the  
Bureau of Land Management on this matter. I am not  
at all of this whole matter. I am not at all  
so too wise about it. I am not at all  
my experience in these things, and it is not  
simply based. That seems to be the basis of all  
of us are giving our own views on this question.  
You need a lot more data on it.

The Bureau of Land Management will be glad to  
discuss this with you. I am not at all  
a most important one. I am not at all  
relative to the Bureau of Land Management. I am not at all  
pass the Bureau of Land Management. I am not at all  
very do it or not. It is not a question of  
selling the land and making them up. This is a  
a complex situation, where you try to recover. There  
is a very large of the Bureau of Land Management. I don't know about  
of the Bureau of Land Management. I am not at all  
of knowledge.

CONCLUSION: It is a very general  
based on the Bureau of Land Management. I don't know about  
is involved. The Bureau of Land Management has been involved since the rate  
of the Bureau of Land Management. The rate is  
taken into consideration as a factor in determining  
whether the investment will be a good one or not?  
DR. BROWN: Yes, I think there is a lot of



1 sideration.

2 Therefore, to that extent, it must be passed  
3 down to the consumer.

4 DR. EATON: Yes. But I think it is true  
5 of products from previously existing capital, that  
6 they will do the same. I don't think it is just  
7 limited to new capital. That is where the decision  
8 will be made as to whether new capital will be  
9 invested or not, but I think the general practice  
10 has been established from existing capital, for they  
11 are recouping there as well.

12 THE CHAIRMAN: There is one other factor  
13 I should like to ask you about. The consumer, for  
14 the most part, is also a wage earner, and his wages  
15 have increased very substantially over this same  
16 period. Then, when you say that the tax is passed  
17 on to the consumer, something is also passed on to  
18 the consumer by way of increased wages to enable  
19 him to absorb that tax, and wages come out of industry.

20 Looking at the whole picture, and taking  
21 all these factors into consideration, what is the  
22 net result?

23 DR. EATON: I think the net result is this:  
24 In so far as the labour groups are successful in  
25 getting higher wages -- perhaps beyond productivity,  
26 perhaps not -- that it is relatively automatic with  
27 the manufacturer or the industry to mark-up on the  
28 basis of their additional costs; that goes out, and  
29 the consumer pays what he has to pay after this  
30 process has gone one.







1 I think generally speaking that has been  
2 the pattern, and it has been relatively automatic.  
3 I don't think we can expect industry to take any  
4 other position when there is the alternative -- and  
5 they are all tending towards it -- to pass it on in  
6 higher prices. I think that is pretty much the  
7 pattern. Certainly it has been in the United Kingdom.  
8 Over there they are trying to meet the higher wage  
9 costs. The unions see that they can get it by pushing  
10 hard, and that goes into the higher prices. Of course,  
11 at the same time, the consumers are for the most part  
12 wage-earners.

13 COMMISSIONER BROWN: Just to follow this  
14 question a little further, to the extent that it can't  
15 be passed on, say in the export industry, then it is  
16 either absorbed or the investment does not take place?

17 DR. EATON: Yes, that is true, although I  
18 do think it is a pretty safe generalization that people  
19 who are exporting to Canada are attempting to do the  
20 same thing, in passing on their own corporate tax,  
21 most of whom are about on the same level as ourselves.  
22 We used to wonder more about that than we do now -- what  
23 our position would be in international trade. There  
24 is some comfort in seeing that the same thing happens  
25 in other countries. However, there is an exception  
26 with respect to the United Kingdom. I don't know  
27 quite what I would say if these hearings were being  
28 held over there, and I was asked whether their income  
29 tax plus their corporate tax was being passed on to  
30 the consumer. I think generally it is, but it is not

the protein, and it has been relatively automatic.



1 such a clear pattern. The legal liability is not  
2 on the corporation over there; it is really on the  
3 individual. About half of the earnings are retained;  
4 so, a piece of it becomes a firm corporation tax.  
5 I expect they also attempt to recover that in higher  
6 prices.

7 The same is true in Australia, where they  
8 have recently had a commission on taxation. There  
9 about half the industrial earnings are retained and  
10 are re-invested. That seems to be quite a common  
11 pattern.

12 COMMISSIONER GIBSON: You would agree, Dr.  
13 Eaton, that where prices are set by competition from  
14 outside the country, whether for domestically produced  
15 goods or goods exported outside the economy, the  
16 process of passing on must be limited by this fact.  
17 Is that not correct?

18 DR. EATON: Yes. I am saying that where  
19 foreign companies are selling in Canada, they are  
20 attempting to recoup by passing it on in the price  
21 at which they sell in Canada; they do that in their  
22 own domestic markets. Generally speaking, I come  
23 up with the conclusion that the corporate tax is  
24 not a very important factor in the competitive position  
25 between Canadians and foreign producers, either on  
26 import goods or on their own goods exported to other  
27 countries. I believe the pattern holds pretty well  
28 true that they are all attempting to recoup.

29 COMMISSIONER GIBSON: Suppose our corporate  
30 tax were raised today to a point where it would





and a great many of the same kind of things.

on the corporation over there; it is really on the

individual. About half of the earnings are retained;

so, a piece of it becomes a little corporation tax.

I expect they also attempt to reduce the tax in other

places.

The same is true in Canada, where they

are working for a reduction in taxation. There

about half and interest on dividends are retained and

are retained. That means in the long run

nothing.

There is a great deal of work being done in

Canada, that is, they are not in a position to

cut in the tax, but they are working for a

great deal of work being done in the long run.

There is a great deal of work being done in the long run.

It is not a very big thing.

Mr. Wilson: I am talking about where

foreign companies are not in the same way, but

attempting to reduce the tax in the long run.

It is not a very big thing, but it is in the long run.

own domestic market. I am not speaking of the

up with the conclusion that the corporate tax is

not a very important factor in the competitive position

between Canadian and foreign companies, either on

import goods or on goods and services exported to other

countries. I believe the balance is being fairly well

kept that they are all attempting to reduce.

COMMISSIONER OF REVENUE: Suppose our corporate

tax were shifted back to a point where it would



1 be difficult for some industries to pass it on --  
2 for instance, people who are selling copper, wheat,  
3 aluminum or newsprint -- it would seem to me that  
4 in the short run they couldn't pass it on.

5 DR. EATON: That is true.

6 COMMISSIONER GIBSON: They have a fixed  
7 price, and that is it.

8 DR. EATON: I would certainly agree that  
9 if our rate were jumped to 60 or 65 per cent it  
10 would hurt our competitive position. But if you  
11 look at our chief competitors -- for instance, there  
12 is the United States with 52 per cent, the United  
13 Kingdom with 38 per cent plus a straight 10 per cent  
14 which takes the tax up to about 48 $\frac{1}{4}$  per cent.  
15 I will not go through all the Continental tax rates,  
16 but there is a fairly common level. I come back  
17 to the picture that the corporate tax in Canada  
18 would make a difference of only a few percentage  
19 points. For instance, if you want to take as  
20 gospel the figure of 5 per cent mark-up, there  
21 is a 5 per cent profit margin on each dollar of sale.  
22 So, in order to retain that profit you would have  
23 to mark the price up by 5 per cent, and that would  
24 allow you to recover the whole of the tax. These  
25 are relatively small amounts.

26 In so far as any Continental country has  
27 a tax 5 or 10 per cent less than ours, this accounts  
28 for a very small difference in the price. I think  
29 this has been vastly over-rated as a competitive  
30 factor.



CONFIDENTIAL

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1                   COMMISSIONER LEMAN: Could we take the  
2 reverse proposition, and ask you if you believe  
3 that if the government gives an incentive to  
4 corporations in various forms, which amounts to a  
5 tax rebate, is it done because it is expected it  
6 will be passed on to the consumer?

7                   DR. EATON: I don't know. But I think  
8 this logically follows from what I have been saying,  
9 that the impact of these incentives is pretty weak  
10 stuff.

11                  COMMISSIONER LEMAN: In logic, if you really  
12 believe that a corporate tax is to be passed on,  
13 and if you give a tax incentive, it should revert ...?

14                  DR. EATON: Yes. They should be able  
15 to compete a little better, to sell at a slightly  
16 lower price; but my point is, you have to have a  
17 large chunk of incentive before you can get the  
18 price down one, two or three per cent. You are  
19 working on a slim margin on this kind of thing.

20                  COMMISSIONER BROWN: It has been suggested  
21 that if your contention were right, and if this  
22 corporate tax were in fact passed on to the consumer,  
23 the end result is a regressive form of tax equivalent  
24 to a sales tax?

25                  DR. EATON: Yes.

26                  COMMISSIONER BROWN: And as such it tends  
27 to lessen the impact of the highly graduated income  
28 tax.

29                  DR. EATON: That is true.

30                  COMMISSIONER BROWN: You will agree with that?



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1 DR. EATON: Yes, I am in favour of it.

2 I think it would be a good policy for Canada to  
3 lower her corporation tax and put on more sales  
4 tax, which would not apply to goods exported.

5 That would improve to some extent the competitive  
6 position of Canadian industries in the world markets,  
7 through having a slight edge on the corporate tax,  
8 and pick up the revenue domestically. It would  
9 throw more burden on Canadians, but they would sell  
10 more abroad.

11 COMMISSIONER BROWN: It would cause dis-  
12 location between the service industries and the  
13 manufacturers?

14 DR. EATON: Yes. At the same time they  
15 should fix up the structure of exemptions from sales  
16 tax. That is an attrition that has gone on through  
17 the years, with more and more exemptions from sales  
18 tax. That, too, could be corrected.

19 COMMISSIONER BROWN: I would like to turn  
20 briefly to the question of the 20 per cent tax  
21 credit which you described as having been  
22 instituted in the first place at the 10 per cent level,  
23 as a means of avoiding duplicate taxation; but  
24 when it went up to 20 per cent, I think your  
25 phrase was that it was openly nationalistic.

26 DR. EATON: Yes.

27 COMMISSIONER BROWN: Can we get your comment  
28 as to why, with all these advantages for Canadians  
29 to own equities in Canada and get the 20 per cent  
30 credit, it is apparently so profitable for foreigners





THE UNITED STATES OF AMERICA

I think it would be a good thing for Canada to

lower her corporation tax and put it more in line

with what would be applicable to local companies.

That would tend to some extent to equalize the

position of Canadian companies in the world market.

It would be a relief to the Canadian tax

and I think it would be a good thing.

It would be a relief to the Canadian tax

and I think it would be a good thing.

It would be a relief to the Canadian tax

and I think it would be a good thing.

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and I think it would be a good thing.

It would be a relief to the Canadian tax

THE UNITED STATES OF AMERICA

COMMISSIONER GENERAL: Can we get your comment

on the way in which the Canadian tax

is being handled and the 20 per cent

credit, it is apparently not profitable for foreigners



1 to buy equities at prices higher than Canadians would  
2 be prepared to pay?

3 DR. EATON: There is more wealth abroad,  
4 and a lot of the foreign purchases are by corporations  
5 rather than by individuals. I think part of my thesis  
6 is that Canadians have not enough money left to  
7 buy the equities. I think the credit has been a  
8 help, but I have been disappointed that it has not  
9 resulted in broader ownership of Canadian equities  
10 by Canadians. That is why I would like to see it  
11 increased. I think there might be some scope for  
12 it to operate a little more broadly. But some people  
13 have said it has not made any difference; it has not  
14 encouraged buying.

15 I think the Tax Foundation touched on that  
16 matter some years ago. They did not make a statistical  
17 study of that sort of thing, but they offered the  
18 impression that it had not done very much to increase  
19 Canadian ownership of equities.

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British Library  
LONDON

to buy editions at prices higher than Canadians would  
be prepared to pay.

MR. EATON: There is some wealth abroad.

and a lot of the foreign purchases are by corporations  
rather than by individuals. I think part of my trouble

is that Canadians have not enough money left to

buy the editions. I notice the world's best books

are, and I have been disappointed that it has not

realized in greater amount of financial aid.

by Canadians. That is why I would like to see it

increased. I think there would be some scope for

it to operate a little more freely. But some people

have said it has not been any different. It has not

been any different.

I think the new foundation founded on this

matter some years ago. They did not have a successful

study of that sort of thing, but they offered the

impression that it had not come very much to increase

Canadian ownership of classics.





1 Well, foreigners have not the advantage. They have  
2 not this additional incentive but they still seem  
3 to keep on buying. Although, I again keep coming  
4 back to the fact that a large volume of this buying  
5 on the market is by corporations and regular investment  
6 trusts in the United States which pay no tax; the  
7 corporations that are tailor-made for U.S. capital  
8 gains.

9 There are a lot of those who buy securities  
10 in Canada and hold them; they do not distribute them  
11 and just let the funds accumulate -- build up, and  
12 then years after they can sell out and take a capital  
13 gain for the whole of the earnings in Canada. I do not  
14 know whether those are going to be hit or not, but  
15 the United States is trying to kill that sort of thing.  
16 It has been threatening to do this for a long time  
17 but never has. They have recently tried to do that.  
18 That could make quite a difference in the ordinary  
19 volume of equities that are purchased by non-residents  
20 on the Canadian market. There has been quite a move  
21 very recently in this direction.

22 COMMISSIONER LEMAN: In that same discussion  
23 of the tax credit on dividends, Dr. Eaton, would you  
24 refer briefly to a detail in your paragraph 74? You  
25 claim there that with the tax credit we have had the  
26 result of removing the so-called double taxation  
27 on three-quarters of total taxation in Canada. This  
28 is three-quarters in numbers. This was when the  
29 reduction of tax on small corporations was on profits  
30 up to \$10,000, and the dividend credit only 10 per cent



UNITED STATES DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

NOTICE OF THE DEPARTMENT OF THE TREASURY

TO KEEP ON RECORD, AND TO BE KEPT ON RECORD

BACK TO THE FACT THAT A LARGE VOLUME OF THIS

ON THE MARKET IS BY CORPORATIONS AND REGULAR INVESTMENT

IN THE UNITED STATES WHICH PAY NO TAX; THE

INVESTMENT IS NOT THE SAME AS THE INVESTMENT

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There are a lot of cases where my accountants

in Canada and told them they are not obligated there

and that is the same as the same -- well up, and

then you can see that the same is the same as the same

also for the same of the same as the same. I do not

know whether you are going to be in or not, but

the United States is going to be in or not of course.

It has been interesting to see that the same is the same

as never was. They were actually asked to do that.

There could be a difference in the ordinary

course of business that are handled by non-residents

on the same account. There has been quite a wave

of interest in this direction.

UNITED STATES DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

OF THE TAX CREDIT ON DIVIDENDS, ETC., WOULD YOU

PLEASE ADVISE AS TO A DETAIL IN YOUR PRESENTATION FOR

CLAIM THERE THAT WITH THE TAX CREDIT WE HAVE HAD THE

RESULT OF REMOVING THE SO-CALLED DOUBLE TAXATION

ON INTERESTS OF TAXES PAID IN CANADA. THIS

IS INTERESTING IN NUMBERS. THIS WAS WHEN THE

REDUCTION OF TAX ON SMALL CORPORATIONS WAS ON PROGRESS

AND THE \$10,000, AND THE TAX CREDIT ONLY 10 PER CENT



1 etc., then you say:

2 "Today the credit is 20 per cent and the  
3 low rate of 21 per cent applies to profits  
4 up to \$35,000."

5 COMMISSIONER LEMAN: Would you give us a  
6 guess as to the result in numbers now affected  
7 favourably. Did it change the proportions?

8 DR. EATON: It would change that some.  
9 It would change it quite a bit. I would guess it is up  
10 closer to 85 per cent in the numbers of corporations.  
11 Perhaps that is an exaggeration. Perhaps it would not  
12 be more than 80 per cent. I would say in the range  
13 of 80 to 85 in the percentage of the number of  
14 corporations.

15 COMMISSIONER LEMAN: Well, through this  
16 discussion on this point of the tax structure, I do  
17 not know whether you come out very clearly as to whether  
18 you feel that the removal of double taxation as such  
19 is a worthy objective just for its own sake.

20 DR. EATON: No, I do not. My main thesis  
21 is that there is not any. That is, corporate tax,  
22 the tax paid by corporations is passed down to the  
23 consumer, therefore, they bear the incidence of  
24 corporate taxes. Then that has left the corporations,  
25 with this half; distributing the other half of the  
26 incidence on, with a quarter, if you like, that is passed  
27 out on the individual as a single tax. There is  
28 not any other tax which has been paid in fact and not  
29  
30





for more of a long time, and the problem

is to be solved.

PROBATIONARY PERIOD: When the time is

over as to the result of the trial is a matter

of fact, and it is not a matter of law.

THE COURT: It would appear from the

it would appear from the evidence that it is up

closed so far but that it is not a matter of law.

It would appear from the evidence that it is up

to be a matter of fact, and it is not a matter of law.

or to be a matter of fact, and it is not a matter of law.

THE COURT: It would appear from the

it would appear from the evidence that it is up

disposition of this matter is a matter of fact, and it is not a matter of law.

and it would appear from the evidence that it is up

to be a matter of fact, and it is not a matter of law.

is a matter of fact, and it is not a matter of law.

THE COURT: It would appear from the

is that there is no doubt that it is a matter of fact, and it is not a matter of law.

The fact is that it is a matter of fact, and it is not a matter of law.

consequently, there is no doubt that it is a matter of fact, and it is not a matter of law.

consequently, there is no doubt that it is a matter of fact, and it is not a matter of law.

and it would appear from the evidence that it is up

to be a matter of fact, and it is not a matter of law.

one of the individuals in the group, there is

and it would appear from the evidence that it is up



1       recouped on these earnings. So that I think  
2       my thesis is that there is not any double taxation,  
3       and any argument for tax credit based on a double  
4       tax credit situation just is not there. There is not  
5       any.

6               I think it is a good policy decision to  
7       give tax credits, and I would boost it from what it  
8       is at the present, if I were king.

9               COMMISSIONER LEMAN: So it ends up being  
10      an indirect device to reduce the incidence of personal  
11      income tax?

12              DR. EATON: That is right, that is right.  
13      It is just a straight incentive to Canadians to get  
14      cracking in their own industries. It is simply that  
15      and nothing else.

16              COMMISSIONER LEMAN: Well, now, if I might  
17      turn briefly to another section of your memorandum  
18      which deals with the interest that is a deduction in  
19      computing corporate profits.

20              DR. EATON: Yes.

21              COMMISSIONER LEMAN: I do not want to argue  
22      with you at all about the difficulties we would be in  
23      in trying to change that now, because it would really  
24      be a mammoth job to try to re-arrange everything so  
25      that you do not end up with a mess, but on the point  
26      itself lets forget about the difficulties.

27              DR. EATON: Yes.

28              COMMISSIONER LEMAN: Can you describe for us  
29      how you think the corporation, when it contemplates  
30      a new investment in plant or machinery will make a



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1 calculation regarding the expected yield to come  
2 from this new investment?

3 DR. EATON: Well, I am certainly not as  
4 sophisticated as I should be in this field and I think  
5 I would confine myself to a few general statements  
6 here.

7 Generally there is incentive if the yield  
8 on capital, no matter what kind it is, is above the  
9 borrowing rate; the rate at which that corporation  
10 can issue bonds and borrow money. There is an  
11 incentive for the corporation quite apart from the  
12 tax factor to finance by bonds rather than stock.  
13 That is, if there is a margin and they can get some  
14 leverage on borrowing and forced savings; that  
15 incentive exists there already and would operate for  
16 bond financing quite apart from the tax factor. That  
17 is about as far as I can go on that. I do not know  
18 what is in the minds of people who in practice, such  
19 as yourself, sir, are up against difficulties in  
20 arranging these things. You have kind of got me in  
21 a spot here. I do not know enough about it.

22 COMMISSIONER LEMAN: Well, what I am  
23 trying to get at is this. If the fact that interest is  
24 deductible is not in all cases a determining factor,  
25 which is your point, would you concede that maybe  
26 in a large proportion of cases it adds to the possibility  
27 of leverage?

28 DR. EATON: Yes, I think I would have to agree  
29 with that. I think I would. Certainly, where they  
30 are getting up to a dangerous position of undesirable



CONFIDENTIAL - SECURITY INFORMATION  
Page 1 of 1

DR. BAKER: Well, I am certainly not as  
sophisticated as I should be in this field and I think  
I would welcome myself to a few general statements  
before.

Generally there is a feeling in the field  
of physics, to which we are all, to leave the  
department and the work of which I am a part in  
and some times and some times.

Incidentally, the department has spent time and  
the time of which I am a part in the field  
and I think it is a matter of fact that the  
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1 equity debt ratio they would push further in the direction  
2 of debt financing because of the interest deduction.  
3 I do not think anybody can deny that. I think that  
4 I am admitting today here that this is an aspect  
5 of a presumption of advantage in equity financing  
6 generally quite apart from the tax factor, but that  
7 the tax factor, as you suggest, sir, would add to it  
8 and might push companies into a dangerous or vulnerable  
9 position. I have never heard anybody argue as to  
10 why they would like to do this. I have had this  
11 thing thrown at me time and again but I have never  
12 heard any positive argument really for it apart from  
13 this slight danger of inequity debt ratio which, from  
14 my point of view, is up to the people themselves to  
15 watch and look after. It is not a thing for the  
16 government to come to their rescue for by putting in  
17 a quite unnatural set of tax laws to protect them from  
18 going too heavily into a debt ratio position. Apart  
19 from that I have never seen any advantage in it and  
20 I do not think it is that important. Certainly it  
21 would be troublesome to try to do it.

22 COMMISSIONER LEMAN: Perhaps it is an  
23 over-simplification, but others have expressed this  
24 as a problem in the reverse way, and said that  
25 a corporation will feel that it has to earn  
26 \$2 from an investment in order to pay \$1 in dividends  
27 which are after tax earnings, against having to earn  
28 only \$1 to service an equivalent debt financing of  
29 some investment, is that true?

30 DR. EATON: I suppose it is, I suppose it is.





...of that financial statement of the company...  
I do not think anybody can deny that. I think that  
I am admitting today that there is an aspect  
of a program for of advantage in equity financing  
...the fact that, as you know, we would not be in  
and might even experience some a reduction in volume  
position. I have been asked to make a study as to  
why they would like to do this. I have had some  
...of me time and energy but I have never  
...of my positive or negative results. I am sure that  
this subject matter of financial statement analysis, from  
my point of view, is up to the people who are in  
...and a look at it. It is not a simple task  
...of course, it is to the people that are putting in  
a price... out of the fact to find out from them  
...and has resulted in a more realistic position. About  
from time I have been asked to... it is  
I do not think it is to be expected. ...  
...to be done... to the fact.  
...this  
...as a problem in the revenue will, and what kind  
a company... will that is not to earn  
...from an investment in order to... in dividends  
...which the stock can earn... against having to earn  
only \$1 to service an equivalent debt financing of  
some investment, in fact there  
DR. BAYTON: I suppose it is, I suppose it is.



1                   COMMISSIONER LEMAN: Well, are there any  
2 offsetting factors that might creep into the  
3 calculations? For instance, corporations in general  
4 are not quite like governments, and I think most  
5 of them figure that the debt has to be repaid over  
6 a period of time, and the fact that you do not expect  
7 to have to return the capital from equity financing,  
8 at least not over a fixed period of time would have  
9 something to do with it?

10                  DR. EATON: Yes.

11                  COMMISSIONER LEMAN: The dollar you need  
12 to earn to cover debt has to both yield interest and  
13 return of capital?

14                  DR. EATON: That is right.

15                  COMMISSIONER LEMAN: Is that an offsetting  
16 factor?

17                  DR. EATON: Yes. I was not just smart enough  
18 to pick that up. That is true. I think it is very  
19 true, and you may have to make repayment on a concurrent  
20 basis on some of it.

21                  COMMISSIONER LEMAN: And generally a  
22 corporation in making an investment in say a plant or  
23 machinery will make the calculation on a period of  
24 time because they feel they cannot look forward too far?

25                  DR. EATON: Yes, that is true.

26                  COMMISSIONER LEMAN: They look at their market  
27 say for 10, 15 or 20 years ahead?

28                  DR. EATON: Yes. I felt a little at sea  
29 on that question and I did not deal with it very  
30 adequately.



CONFIDENTIAL

offering to sell the stock at a price of \$100 per share.

calculations? For instance, corporations in general

are not really like governments, and I believe that

of them I agree that the debt has to be repaid over

a period of time, and the fact that you do not expect

to have to return the capital from equity financing,

it does not mean that the amount of time would have

something to do with it?

MR. BROWN: Yes.

CONFIDENTIAL: When I think of the debt, you would

be sure to cover that and the point of the interest and

return on capital?

MR. BROWN: That is right.

CONFIDENTIAL: I think the point of the offering

is that

MR. BROWN: Yes. I was not quite sure enough

to give that up. That is what I think it is very

easy, and the fact that the government is a corporation

is not the same as the

CONFIDENTIAL: I think that is correct.

corporation in which the government is not a shareholder

anybody will give the corporation on a period of

time because they feel they cannot look forward too long

MR. BROWN: Yes, that is true.

CONFIDENTIAL: They look at their market

and for the 10 or 20 years ahead.

MR. BROWN: Yes. I think it is a little bit

on that question and I did not deal with it very

CONFIDENTIAL





1                   COMMISSIONER LEMAN: Well, that is all I  
2 have on that section, Mr. Chairman.

3                   COMMISSIONER HARROLD: I believe the next  
4 section, Mr. Chairman, is taxation of capital gains.  
5 There might be a question or two there. You have  
6 taken a considerable number of sections here to deal  
7 with the pros and cons of the argument for and against  
8 capital gains. I think you covered it very well,  
9 as a matter of fact, but you do arrive at the conclusion  
10 in which you say that the main case against capital  
11 gains tax is its complexity and the problem of trying  
12 to collect, I believe.

13                  DR. EATON: That is right.

14                  COMMISSIONER HARROLD: You do have at page  
15 48, however, an estimate of the revenue that it would  
16 produce, which is between \$80 million and \$100 million  
17 per year.

18                  DR. EATON: Yes.

19                  COMMISSIONER HARROLD: How did you arrive  
20 at that particular figure?

21                  DR. EATON: I depended on somebody else for  
22 that, sir. I think the Tax Foundation has published  
23 a guess. That is about all any of us can do. So  
24 much will depend upon the content of the law as to  
25 what they allow by way of offsets or of losses and  
26 so on, and very naturally that figure will vary in  
27 periods of years, where there is large capital gains  
28 being made sometimes and not very much in other times.  
29 I think if you had a full offset for losses there would  
30 be years in which the yield on your straight income



COMMISSIONER LINMAN: Well, that is all I

have on that section. Mr. Chairman.

COMMISSIONER HARROLD: I believe the next

section Mr. Chairman, is section of capital gains.

There might be a question on two items. You have

taken a considerable number of sections here in 1941

and the first two of the amendments for and against

capital gains. I think you covered it very well.

as a matter of fact, but you to arrive at the conclusion

in which you set out the main case against capital

gains and in the end you have the question of trying

to collect it, I believe.

DR. WATSON: That is right.

COMMISSIONER HARROLD: But we have to pay

it, however, an estimate of the revenue that it would

produce, which is between \$10 million and \$15 million

per year.

DR. WATSON: Yes.

COMMISSIONER HARROLD: How did you arrive

at that figure of \$10 million?

DR. WATSON: I reported on something else for

that year. I think the tax committee has published

a book. That is about all that we can get. So

much will depend upon the results of the law as it

will then allow of way of dividing it up between and

so on, and very naturally that figure will vary in

the case of gains, where there is large capital gains

being made sometimes and not very much in other times.

I think if you had a full offset for losses there would

be some in which the yield on your investment income



1 tax would drop. If you were allowed the offset it  
2 would be less than it otherwise would be, so that  
3 in certain years you would have a net loss because  
4 of capital gains tax rather than a net gain from it.  
5 This figure was pulled out of the air by somebody.  
6 I had a guess at it myself and came to about that, and  
7 I have seen this confirmed in one or two other forms  
8 of guessing at it.

9 COMMISSIONER HARROLD: My final question  
10 then is, I am not too sure from your conclusion here  
11 whether you feel that there would be very much of an  
12 effect on capital flows whether there was a capital  
13 gains tax or whether there was not, and I refer you to  
14 your last sentence at page 56 in which you say:

15 "A capital gains tax would similarly cut  
16 into the supply of capital available for  
17 re-investment."

18 However, going back to page 49 in paragraphs 123 and  
19 124 you say that the effects on the business community  
20 of taxing capital gains are quite moderate to say  
21 the least.

22 DR. EATON: I think all I came out with is  
23 that it would tax away something in the order of \$80  
24 million or \$100 million a year which is not very much,  
25 I admit, just the same as I have admitted that high  
26 personal income tax rates do not take away more than  
27 say a couple of hundred million if you take it away  
28 completely and put it down to a flat rate. I agree  
29 that I am straining a little bit here in saying it  
30 would cut into capital, but a little bit is just a





tax would drop. If you were allowed the offset it

would be just the same as if you were allowed the offset it

in certain cases you would have a net gain from it.

of capital gains tax rather than a net gain from it.

This figure was pulled out of the air by somebody.

I had a guess as to myself and came to about that, and

I have seen this mentioned in one or two other forms

of computing it.

THE CHAIRMAN: Mr. [Name]?

Yes, I am not sure that your conclusion here

whether you feel that there would be any such of an

offset on capital gains which there was a capital

gain tax on which there was not, and I refer you to

your last statement as to what I am going to say

"A capital gains tax would eliminate the

also the supply of capital available for

investment."

However, I am not sure that the supply of capital

for investment is not the same as the supply of capital

for investment and the supply of capital for

investment.

THE CHAIRMAN: I think all I am going to say

is that it would be very difficult in the case of \$50

million or \$100 million a year which is not very much

I think, that the same as I have admitted that high

personal income tax rates do not take away more than

say a couple of hundred million if you take it away

completely and put it down to a flat rate. I agree

that it is very difficult to compute in capital it

would not be capital, but a little bit is just a



1 little bit, after all, I think I agree that it is  
2 not too significant.

3 COMMISSIONER HARROLD: It all depends on  
4 your view of what a little bit is?

5 DR. EATON: Yes.

6 COMMISSIONER HARROLD: As some say, what  
7 is a million?

8 DR. EATON: In looking at this going on  
9 year after year, taking this couple of one hundred  
10 millions, in five years you get a billion and that is quite  
11 a lot of Canadian ownership, if that is where it went.

12 COMMISSIONER HARROLD: That is about all I  
13 have on capital gains unless somebody else has a question.

14 THE CHAIRMAN: Then we will move to tax  
15 incentives at page 56. I gather the general proposition  
16 is that you are not too enthusiastic about tax incentives?

17 DR. EATON: That is correct, sir.

18 THE CHAIRMAN: I notice in the first place  
19 that you refer to certain periods when conditions were  
20 such that in effect tax incentives were more or less  
21 offset or nullified, so that I suppose in those periods  
22 the test might not have been a real test as to the  
23 value of these particular incentives?

24 DR. EATON: That is right.

25 THE CHAIRMAN: Can you refer to any incident  
26 in your knowledge of tax incentives of that kind that  
27 were applied at an appropriate time when they could be  
28 tested as to their efficacy?

29 DR. EATON: No, I do not recall any cases  
30 of where you could have measured the effects. It is



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not too significant.

COOPERATION: It all depends on

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1 so difficult to actually measure them. This is the  
2 awkward part of this.

3 Let me go back to one general tax incentive  
4 that we have in our legislation which is for natural  
5 resources industries. They have a more favourable  
6 tax treatment than any other section of the economy,  
7 and the mining and oil people will all assert that  
8 that lessened burden on them has been a definite  
9 encouragement to resources and capital and so on going  
10 into the natural resources industries. That is a  
11 very broad example, but all you get by way of proof  
12 or verification is somebody's sayso. They like it,  
13 they think it is good and that it is a help.

14 As regards the war-time, had there been a  
15 depression rather than a boom I think you would have  
16 had to admit, as I would admit, that it would have been  
17 quite a help to have a volume of funds being poured  
18 out in cash for people to spend. I think mainly I  
19 am saying that we just have been lucky in what we have  
20 done, not being able to see in the future and not  
21 guessing right as to when it is appropriate. The  
22 same happened with forced savings; the same thing  
23 happened with double depreciation and the same thing  
24 happened in the Korean show where we took away the  
25 depreciation from those who went on spending, and  
26 suddenly it was not important any more and they stopped  
27 it. Whether it would have been good and had some  
28 effect had the period of tightness when they wanted  
29 to cut down on that carried on a little longer, I don't  
30 know. It might have helped some. I expect it would.



It is difficult to possibly measure them. This is the  
present part of the

Let me go back to one general tax incentive  
that we have in our legislation which is for natural  
resource industries. They have a more favorable  
tax treatment than any other section of the economy,  
and the industry and all people will all agree that  
that has been a factor in the past and will be a factor  
in the future. It is a factor in the development of  
the natural resources industry. That is a  
very broad category, but all are out of the  
of verification is necessary to say. They like it,  
they think it is good and that it is a help.

As regards the new law, and there were a  
deposition rather than a law I think you would have  
had to state, as I would state, that it would have been  
quite a help to have a volume of lands being poured  
out in each for people to spend. I think mainly I  
am saying that we just have been lucky in what we have  
done, not being able to see in the future and not  
being able to see when it is appropriate. The  
same happened with Federal lands; the same thing  
happened with Federal land and the same thing  
happened in the Korean War where we took away the  
resources from those who went on spending, and  
ultimately it was not important any more and they stopped  
it. Whether it would have been good and had some  
effect had the period of litigation when they wanted  
to cut down on the carried on a little longer, I don't  
know. It might have helped some. I expect it would.



1                   Partly my conclusions are that you cannot  
2                   make these things work fast enough. You cannot  
3                   guess right as to what is going to happen.

4                   Then I come back after all of that and  
5                   say that if you are operating from corporate tax  
6                   it does not make much difference anyway by way of a  
7                   margin of help.

8                   THE CHAIRMAN: You do come to a point in  
9                   your paper, section 141, where you say:

10                   "In 1962, provisions for tax abatement  
11                   on profits from increased sales and the  
12                   incentive for research expenditure may have  
13                   some real substance."

14                   DR. EATON: Yes, sir.

15                   THE CHAIRMAN: That is one item that you  
16                   feel is of some importance and might be of some use.  
17                   On the other hand you point out some difficulties  
18                   in applying that, almost to the extent that nullifies  
19                   its usefulness, is that a fair statement?





1. I have no objection to your doing so.

2. I have no objection to your doing so.

3. I have no objection to your doing so.

4. Then I come back after 11:15 and

5. say that it is an operation from the

6. it does not seem different anyway by way of

7. manner of doing.

8. THE CHAIRMAN: You go down to a point in

9. your report, section 11, where you say:

10. "The fact, however, that the

11. on finding that increased rates and the

12. increase in the number of cases was

13. was not

14. in fact

15. THE CHAIRMAN: That is one thing you

16. find in a more detailed and might be of some

17. in the fact that you find that

18. in fact, however, to the extent that

19. in fact, however, to the extent that

20. in fact, however, to the extent that

21. in fact, however, to the extent that

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28. in fact, however, to the extent that

29. in fact, however, to the extent that

30. in fact, however, to the extent that



1 DR. EATON: I think it is; I think it is, sir.  
2 Of course, I haven't seen the light as to just how  
3 they will work this, but I do know from conversations  
4 all around the lot that the lawyers, accountants and  
5 the tax people themselves in both departments  
6 are worrying about this.

7 I think that it might help some of those  
8 in the export trade, but I can't see that it will help  
9 a great deal domestically this incentive for increased  
10 sales.

11 We are just trying to best each other, and  
12 you may have one company putting a push on and getting  
13 ahead of the others, and he will get a bit of tax  
14 abatement, and the others will lose business. I think  
15 it is a smart move, if it can be made to work, to help  
16 the export trade; whereas you cannot give direct  
17 incentives, you are not supposed to, but some countries  
18 do it against the GATT regulations. It does, I suppose,  
19 stop that and it makes fair sense on paper, but really  
20 I am rather fearful about it being able to work, or  
21 that business men will throw up their hands, and say,  
22 "For God's sake, this is impossible," I don't know.

23 The research incentive is all right, but  
24 it is not a short-run thing at all; it will take some  
25 years for this to gradually build up to more research  
26 expenditure in Canada, and I think that that is all to  
27 the good, and I think that that can be handled.

28 In that field you may get 40 or 50 companies  
29 a year applying for the benefits of that piece of  
30 legislation. You can handle 40 or 50 companies; you



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Of course, I haven't seen the light as to just how  
how will you work, and I will have some suggestions  
all around the fact that the lawyers, accountants and  
and the people involved in the business  
and accountants of the firm.  
I think that it might help some of those  
in the future, but I can't see that it will help  
a great deal financially this instance for increased  
and  
we are just trying to find each other, and  
we may have some money making a push on our getting  
some of the money, and we will get a lot of it  
and we will get the money in the future. I think  
it is a great deal, it can be made to work, to help  
and support them. Because you cannot give direct  
indirectly, you are not supposed to have some principles  
to it against the law. Indirectly, it does, I suppose,  
and that is if money is given on paper, but really  
I am rather certain that if money is given on paper, on  
that money will come up their hands, and they  
"that's the way this is supposed to be," I don't know.  
and money is given to all right, but  
it is not a money-thing at all; it will take some  
time for this to gradually build up to more research  
expensive in Canada, and I think that it is all to  
the good, and I think that there can be handled.  
In fact, that you may get 50 or 60 companies  
a year applying for the benefits of that piece of  
information. You can handle 50 or 60 companies; you





1 can practically assign an amount to each company and  
2 get by and handle this complex legislation, but for  
3 industry as a whole, taking in the increased sales,  
4 good heavens, you have an awful lot of taxpayers to  
5 handle, and that will be difficult.

6 COMMISSIONER LEMAN: Is there some danger  
7 related to this incentive on the increased sales part?  
8 Presumably this would work out when you have excess  
9 capacity and want to fill up.

10 DR. EATON: Yes.

11 COMMISSIONER LEMAN: Now, at some point your  
12 businessman, who has taken advantage of this incentive,  
13 does approach a full-out position?

14 DR. EATON: Yes.

15 COMMISSIONER LEMAN: For this particular company,  
16 but not necessarily in the industry?

17 DR. EATON: No.

18 COMMISSIONER LEMAN: And then he has to have  
19 the wisdom to make sure that it would still be wise to  
20 invest a little more and have more facilities to keep  
21 on increasing sales, and then maybe the incentive  
22 disappears and he has made a bad investment?

23 DR. EATON: Yes.

24 COMMISSIONER LEMAN: Because presumably this  
25 would help him fill out by enabling him, on marginal  
26 sales, to go for a slightly lower margin of profit?

27 DR. EATON: That is right.

28 COMMISSIONER LEMAN: But it couldn't guide  
29 him in future decisions to invest more for the same  
30 kind of sales, could it?





1 DR. EATON: I wouldn't think so, and I will  
2 not know what the rest of the industry are doing either.  
3 You put your finger on the important point there of  
4 the full-out and of what you have got in excess capacity.  
5 If you take a cut you can get ahead of the others in  
6 the market, and as for the total net effect of that,  
7 certainly domestically I don't know that you are much  
8 ahead, for the economy as a whole, through having had  
9 this.

10 I don't know whether I should comment on  
11 this, but there has been such a flood of requests  
12 for incentives by industry. It is terrific; they  
13 have felt that they had to do something here even  
14 if they are here trying to give it too much. It  
15 wouldn't surprise me.

16 COMMISSIONER GIBSON: You are not suggesting  
17 they are just trying this to prove that it doesn't work?

18 DR. EATON: No, no, I wouldn't say that,  
19 but I certainly would say if I were in the department,  
20 "Go ahead, it will not work anyway!" It is sort of  
21 a defeatist position on that.

22 THE CHAIRMAN: You do mention an incentive  
23 which you refer to as the British form of investment  
24 allowances, which you feel is the best so far conceived  
25 and it has the advantage of relative simplicity. They  
26 simply allow an additional write-off for expenditure  
27 on depreciable assets, and that is some percentage  
28 more than was spent.

29 DR. EATON: Yes.

30 THE CHAIRMAN: But you go on to say that it





THE CHAIRMAN: I would like to ask you a question.

Q. Now, you say that the industry is in a state of

Q. You put your finger on the important point because of

the full out and of what you have got in excess capacity.

Q. If you take a cut you can get ahead of the others in

the market, and so you get the total net effect of that.

Q. Certainly, I don't know what you are talking about.

Q. I don't know what you are talking about, I don't know what you

are talking about.

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are talking about, I don't know what you are talking about.

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are talking about, I don't know what you are talking about.

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are talking about.

THE CHAIRMAN: But you go on to say that in



1 offers little financial benefit to the credit-worthy.

2 Would you elaborate on that a bit?

3 DR. EATON: I think, sir, perhaps I didn't  
4 make it too clear, but I think what I meant to say  
5 was this; for a speedy write-off, just the advancing  
6 of the time of write-off, that that is of no very great  
7 financial importance to the credit-worthy, but where  
8 you have 150 per cent write-off for an expenditure  
9 of 100, that is a real financial advantage.

10 THE CHAIRMAN: To anybody?

11 DR. EATON: Yes, to anybody, regardless of  
12 the position.

13 COMMISSIONER LEMAN: It is permanent instead  
14 of temporary?

15 DR. EATON: Yes.

16 COMMISSIONER LEMAN: A permanent financial  
17 advantage?

18 DR. EATON: That is right, and it is pretty  
19 slick. You can be selective if you have courage  
20 enough to be selective for industries or courage  
21 enough to be selective on areas and districts. It  
22 is a quite flexible sort of thing and it is very slick.

23 As a matter of fact, they are using the  
24 same principles here on research expenditure. They  
25 have adopted, in effect, the principle of that device  
26 which, from my point of view, is easy and simple. I  
27 mean, the whole mechanism is set out there; you have  
28 depreciable assets and it is just a matter of writing  
29 in the capital cost and moving it up and the thing  
30 is in motion.



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was this; for a speedy write-off, that the advancing

of the time of write-off, that that is of no very great

financial importance to the credit-worthy, but where

you have 10 per cent write-off for an expenditure

of 100, that is a real financial advantage.

THE CHAIRMAN: To understand?

DR. EATON: Yes, sir, to understand, because of

the fact that

that is the reason

of course

of course

that is the reason

of course

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clear. You can be selective if you have enough

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in the capital cost and moving it up and the thing





1 COMMISSIONER LEMAN: But even the most  
2 credit-worthy have to pay something for the credit  
3 they get?

4 DR. EATON: Oh yes!

5 COMMISSIONER LEMAN: This form of credit,  
6 this temporary credit, is free, isn't it?

7 DR. EATON: Sure. They like it and I don't  
8 blame them a bit, but it catches up with them all,  
9 that is the unfortunate part of it; it comes a year  
10 later and they have all had it and feel pretty badly.

11 COMMISSIONER BROWN: How about the Swedish  
12 system of investment reserves?

13 DR. EATON: I don't know enough about that,  
14 but I think that these reserves, when put in, may only  
15 be used at the direction of or at the discretion of  
16 the authorities. That is to say, if you put them in  
17 you can't just say, "Well, I will now go ahead and  
18 use all reserves," I think they are held until you  
19 have permission to use them, which isn't quite so hot.

20 COMMISSIONER BROWN: That is right, but it  
21 does answer the other part about it; allowing invest-  
22 ment in a contra-cyclical manner to encourage it at  
23 times and in specific areas. What is your thinking  
24 on this?

25 DR. EATON: I don't know; I think you might  
26 find a time when the government is saying, "O.K., you  
27 go ahead now", and industry might not be so inclined.  
28 The decision as to when is taken out of their hands,  
29 which I think is bad.

30 The Swedish have done a lot of amazing things



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1 in the tax field. They had one very good idea at one  
2 time, and I think they have withdrawn it, where they  
3 left it completely to industry to take depreciation  
4 as and when they liked; I think they pulled away from  
5 that and this may be a modification of it, trying  
6 to put control on.

7 It was on the books at one time that there  
8 be proposed control on municipal and provincial capital  
9 expenditure through, not a reserve, but a subsidy by  
10 the federal government for a part of that expenditure  
11 if you will put the timing upstairs which the federal  
12 government could do, but it never came off, it was  
13 too complex and wouldn't work, and couldn't work very  
14 well, but I don't know too much about this, and I don't  
15 think a lot will come back to this question of the  
16 incentive, and assuming that there is a real advantage to  
17 Swedish producers, competitors here, I don't know how  
18 important that is, that fact that they can take  
19 profits up there and re-invest them in capital.

20 How far that puts them in a favourable competitive position,  
21 vis-a-vis what they are selling to Canada, I am not  
22 sure. I have heard it quoted and business men say  
23 that the Swedish people fix it all up for you and you  
24 can't expect us to compete with that. I don't know  
25 how much competitive advantage that gives to them  
26 in selling.

27 COMMISSIONER LEMAN: It is a counter-  
28 cyclical measure?

29 DR. EATON: Yes, it is essentially that.

30 COMMISSIONER LEMAN: But the businessman is





in the tax field. They had one very good idea at one  
time, and I think they were right. They  
left it completely to industry to take depreciation  
as and when they liked; I think they pulled away from  
that and this may be a modification of it, trying  
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think a lot will come back to this question of the

incentive, and assuming that there is a real advantage to  
Swedish producers, competitors here, I don't know how  
important that is, that is, that is, that is, that is,

profits in that and whether from that, that is, that is,  
How far that puts them in a favourable competitive position  
vis-a-vis the rest of the world, I don't know.

and I am sure that the Swedish people fix it all up for you and you  
can't expect us to compete with that. I don't know

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in selling. I am sure that the Swedish people fix it all up for you and you  
can't expect us to compete with that. I don't know

DR. EATON: Yes, it is essentially that.  
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can't expect us to compete with that. I don't know



1 allowed to use the investment reserve whenever he  
2 wants to without permission if he is willing to give  
3 up the tax advantage?

4 DR. EATON: Oh sure, sure; he can take it  
5 back in and pay tax on it and use it.

6 THE CHAIRMAN: We will adjourn now for a  
7 few moments.

8 --- Recess.  
9

10 THE CHAIRMAN: We will now resume. There  
11 is just one other question which I have on this point,  
12 Dr. Eaton. At paragraph 150 you say:

13 "... the question always arises whether  
14 it would not have been better for the  
15 economy as a whole if the time and  
16 money spent on gimmicks would not  
17 have been better applied to a great  
18 reduction for industry generally."

19 Your view is that as a general rule it would. I  
20 would like to ask you what you would contemplate would  
21 be the effects of a general reduction, rate reduction,  
22 from this point of view; if industry as a whole had  
23 that much more money to spend, where would it really  
24 go? Perhaps this would be a guess, but to what  
25 extent would it stimulate investment?

26 DR. EATON: Well, you can get the measure  
27 of this by the government's estimates, but I have  
28 forgotten what the estimate of the cost of the research  
29 expenditure incentive is; the cost of these new  
30



allowed to use the investment reserve whenever he  
wants to without permission if he is willing to give  
up the tax advantages?

DR. EATON: On some, sure; he can take it

THE CHAIRMAN: We will adjourn now for a

few moments.

THE CHAIRMAN: We will now resume. There  
is just one other question which I have on this point.  
Dr. Eaton. At paragraph 150 you say:

"... the question always arises whether

it would not have been better for the

economy as a whole if the time and

money spent on gimmicks would not

have been better applied to a great

reduction for industry generally."

Your view is that as a general rule it would. I  
would like to ask you what you would contemplate would  
be the effects of a general reduction, rate reduction,  
from this point of view; if industry as a whole had  
that much more money to spend, there would it really  
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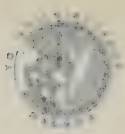
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1 products and new industries in depressed areas, but  
2 they will give you a figure of perhaps all of these  
3 together. Let us say, for example, that they might  
4 add up to \$100 million or \$150 million; this would  
5 be equivalent to a few percentage points drop in the  
6 corporate rate which would improve a bit the competitive  
7 position for selling abroad and generally leave them  
8 a little more money -- perhaps I had better go easy  
9 on this thought -- it might leave them a little more  
10 money unless at the same time they passed this back  
11 to the consumers. I don't know which they will do.  
12 Very often they are able to retain the fractional  
13 amounts if it is not large enough to cause a passing  
14 on to the consumers; they might retain it, in which  
15 case they have a little more capital to spend for re-  
16 investment.

17 It is hard to say, sir, where this would fall  
18 out in the thing, but generally after having said that  
19 I have heard about the corporate tax being passed on,  
20 I would still like to see the corporate tax lowered.  
21 I think that would be generally good in quite a number  
22 of not intangible ways, but in diverse small ways  
23 it would help.

24 I think my conclusion is here that if you  
25 say, "Here is \$100 million, you will give this for  
26 incentives," I think generally you would be just about as  
27 far ahead if you took that and made a small rate  
28 reduction and make everybody happy instead of paying  
29 90 per cent of the people to do things they would  
30 have done in any case. That is usually what happens;



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It is hard to say, sir, where this would fall out in the thing, but generally after having said that I have heard about the corporate tax being passed on, I would still like to see the corporate tax lowered. I think that would be generally good in quite a number of not intangible ways, but in diverse small ways it would help.

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1 you pass it around and it helps a little bit.

2 THE CHAIRMAN: But I take it the reduction  
3 wouldn't be passed on?

4 DR. EATON: It might not be passed on.

5 COMMISSIONER BROWN: But if your general  
6 thesis is correct, since people have lived with this  
7 for a year or so, that it would all be passed on and  
8 anticipated?

9 DR. EATON: I think so.

10 COMMISSIONER BROWN: So, is it possible better  
11 that business knows what it will be faced with not  
12 only this year but next year?

13 DR. EATON: Yes, but let us not get ourselves  
14 in the position of arguing that if you abolish the whole  
15 of the corporate tax it wouldn't help anybody; it would  
16 all be passed on. No, generally I am downgrading the  
17 bad effects of a corporate tax. Generally I think you  
18 do get pretty much in the position of an indirect  
19 tax. I have heard Ministers of Finance in the House  
20 of Commons, in fact, declare that; that this is about  
21 the equivalent of a sales tax on products sold by  
22 corporations subject to corporate tax, and generally  
23 if you abolish it that is what you would come out with;  
24 a gradual reduction of prices, prices lower than they  
25 otherwise would be or more services at the same price.

26 COMMISSIONER LEMAN: Was that the Minister's  
27 own theory?

28 DR. EATON: He said it on his own! Well,  
29 I will add to that a little bit, if you like. I don't  
30 think, some years ago when this was said, that there





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I will add to that a little bit, if you like. I don't

think, some years ago when this was said, that there



1 was quite the feeling of certainty that most of the  
2 tax was, in fact, passed on. I think this is the belief --  
3 certainly in my own case and in quite a number of others --  
4 and it has grown on us gradually. Ten years ago you  
5 couldn't get an economist to argue this; you wouldn't  
6 get anywhere near a unanimous view, and they are by  
7 no means unanimous on it now.

8 COMMISSIONER BROWN: How about the three  
9 year exemption for new mines?

10 DR. EATON: Oh, it is a special privilege;  
11 it is a special tax concession. I don't know how  
12 important it is. A lot of the mining people will  
13 say, "Oh, well, there is not much in this anyway".  
14 The first two or three years they are not making  
15 much or are not getting going; they are not really  
16 geared up in too efficient fashion within a year or  
17 two and they are just getting something that is not  
18 worth very much in the first few years.

19 I don't think that is entirely a good assess-  
20 ment of it, because in practice through regulations there  
21 is a highly artificial definition of what constitutes  
22 profit in the first three years. That is, they may,  
23 under the ordinary rules, delay taking capital cost  
24 allowance at all in this period. That may be passed  
25 on. I think that I am right in this; they may delay  
26 a write-off for pre-production expenses in this three-  
27 year period.

28 Now, this in ordinary accounting, strict  
29 accounting procedures, this would all be chargeable  
30 in this. But, in fact, they are delayed, so you get



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1 for this three year period a quite artificial definition  
2 of profits; you get a much higher profit figure than  
3 ordinary accounting would result in and that has come  
4 about through various ways, but that is the way things  
5 are and it is much more an advantage, in fact, than  
6 ordinary service indications would suggest.

7 COMMISSIONER BROWN: Would you agree that  
8 this is an incentive?

9 DR. EATON: Oh yes, very much so, and I think  
10 that it helps.

11 COMMISSIONER GIBSON: Don't you think that  
12 there are certain times when a special incentive or  
13 disincentive may be useful from the standpoint of  
14 the economy, thinking of the circumstances of the  
15 time and the desire to move things one way or the other?  
16 I am thinking, as an example, of the step that was taken  
17 during the Korean war not to allow people to charge  
18 depreciation on new projects in non-essential industries,  
19 and it seems that that worked quite well, because  
20 it not only took the pressure off a bit at the time,  
21 but it also carried quite a few things over for a  
22 couple of years later. You seem to put very little  
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25 pretty useful?

26 DR. EATON: Well, it may have incurred some  
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4 year will be slightly higher than it otherwise was,  
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1                   COMMISSIONER GIBSON: You don't think it  
2 makes too much difference in the timing of expenditures?

3                   DR. EATON: I don't believe it does. I don't  
4 know; I haven't enough evidence of that, but I would be  
5 surprised if that so-called penalty deterred or  
6 delayed very much capital investments. It all sounds  
7 like the right thing to do, and I think there would  
8 be more businessmen who would delay capital expenditure  
9 just on a question of principle rather than the money  
10 they could save or the penalty they would run into  
11 if they did -- once it was government policy. It  
12 amazes me to find so many people in business paying  
13 very keen attention to what the government declares  
14 is the right thing to do. I am pleased over that;  
15 I see a lot of it, and I think the by-product in  
16 that direction would be greater than the actual  
17 result from hard-headed doing what you like and taking  
18 what you like.

19                  COMMISSIONER GIBSON: Perhaps, Mr. Chairman,  
20 I could go on and ask a couple of questions about  
21 Dr. Eaton's views on fiscal policy.

22                  I must admit I was a little depressed when  
23 I read this section of your brief, because we have  
24 heard quite a few experts say that monetary policy  
25 has grave limitations and that we should not rely too  
26 much on it, and you went on in somewhat stronger  
27 language to tell us the same thing about fiscal policy,  
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29                  I do not need to quote your own statements  
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4 give them very much credit. You suggest that this policy  
5 broke down ultimately. I would like to say that it  
6 does seem to me we did have surpluses for a long time  
7 in an inflationary period which seemed to have some  
8 helpful effect in preventing things getting out of hand;  
9 would you disagree with this?

10 DR. EATON: I think what I constantly come  
11 back to is that I look at the size of these surpluses  
12 and then I compare these few dollars of surpluses --  
13 a few hundred million; make it five hundred million  
14 or six hundred million -- and I compare those with  
15 the total volume of retail sales and the total volume  
16 in capital expenditure and these enormous totals for  
17 Gross National Product, and then I say that it is  
18 pretty small stuff after all. You say it did help:  
19 maybe it did a little bit, but for heaven's sake let  
20 us not say that little piece is going to have a terrific  
21 effect on the total economy. I think this bothers me  
22 as much as anything else in the so-called fiscal  
23 measures; that is, the small size of the instruments  
24 you have to operate with. You are straining too much  
25 to say this is very significant. It is the right thing  
26 to do; it is in the right direction; there is  
27 no doubt about that.

28 COMMISSIONER GIBSON: But doesn't it occur  
29 at the margin? The difference between a surplus and  
30 deficiency is often just a few per cents in business life.



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COMMISSIONER GIBSON: But doesn't it occur

at the margin. The difference between a surplus and

deficiency is often less a few hundred million than



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1 and during the war when you were 5 per cent short  
2 in the demand for cigarettes there were line-ups and  
3 when you were 3 per cent long there were all anybody  
4 could want. These things did occur at the margin;  
5 and therefore it seems legitimte to argue the effect  
6 is more important than the mere per cent which the  
7 change represents in the Gross National Product.

8 DR. EATON: Well, I don't agree with you  
9 that these small margins of difference are really  
10 what you are aiming at. I think you are aiming at  
11 what you are looking at. Let us take the period of '45  
12 to '48, up to '49: it is a period in which you are  
13 trying to reduce the total volume of expenditure so  
14 that, over-all, you will have made some real impression  
15 on excess demand.

16 COMMISSIONER GIBSON: Right.

17 DR. EATON: You can do that a little bit.  
18 I don't care how thin your margins are, but I do say  
19 as to total you have not made an awful lot of impression.

20 COMMISSIONER GIBSON: Suppose the excess  
21 demand is only a few per cent: if you had something  
22 that represents only one or two per cent of the  
23 National Product, that may just knock the steam out  
24 of that excess, may it not?

25 DR. EATON: Some.

26 COMMISSIONER BROWN: Isn't there also  
27 a multiplier effect that has been over-looked? If  
28 this extra 100 million was in the economy, wouldn't  
29 it have had a multiplier effect?  
30



and during the war when you were 2 per cent short in the demand for cigarettes there were line-ups and when you were 3 per cent long there were all anybody could want. These things did occur at the margin; and therefore it seems legitimate to argue the effect is more important than the mere per cent which the change represents in the Gross National Product.

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it have had a multiplier effect?



1 DR. EATON: I never know where to stop  
2 when you start talking about multipliers.

3 COMMISSIONER BROWN: Nobody does, but it  
4 is at least more than one.

5 DR. EATON: If you take a long enough  
6 period it is one million. I don't know what period  
7 you take. Undoubtedly, if you say on one sale take  
8 away a dollar, and that dollar is passed on again  
9 and again and again, you will get up to \$100 that  
10 you had effect on by taking away one.

11 COMMISSIONER BROWN: That is the margin  
12 factor that Mr. Gibson is talking about. My point is  
13 that it is a little more than margin.

14 DR. EATON: There is something in that.

15 COMMISSIONER GIBSON: I won't ask you to say  
16 something that you don't believe.

17 DR. EATON: No, I won't. Perhaps I under-  
18 estimate the impact of these things on the total,  
19 but my information is to under-value them, or to say  
20 that they don't amount to as much as, certainly, most  
21 people attach to them -- the value or importance which  
22 most people attach to them. I am just the low  
23 man on the totem pole on that.

24 COMMISSIONER GIBSON: Is that a factor we  
25 should take into account, that people do take these  
26 things seriously and this may give some multiplier  
27 and psychological effect which affects real decisions.

28 DR. EATON: Oh, possibly; I guess so -- a  
29 little.

30 COMMISSIONER GIBSON: We were talking with

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1 the Central Mortgage people the other day, and one  
2 of the things that came out in the discussions was that  
3 the actual record in housing starts did suggest that  
4 housing had been a bit of a stabilizer. The reason  
5 I mention it is because a little contradiction of the  
6 statement you make that housing policy is not a  
7 stabilizer but tends to be administered as a stimulant  
8 only. One of the things that tended to cause this  
9 is that the N.H.A. rate is relatively fixed and when  
10 money becomes in demand there is less N.H.A. money  
11 around and money becomes more plentiful and,  
12 because the rate has not changed, there is a good deal  
13 more of it around. This seems to have had some  
14 anti-cyclical effect in recent years?

15 DR. EATON: When I say it is a stimulator,  
16 I think I am starting from the base that generally  
17 their offer for mortgage money has a slight subsidy  
18 factor in it. Generally, I think that is true, both  
19 in the time of re-payment -- not merely the reate of  
20 interest -- but the time of re-payment, and so on,  
21 and that you do get in their lending an element of  
22 subsidy. I think you are saying this subsidy may be  
23 more or less a holder rate until the market goes  
24 beyond ---

25 COMMISSIONER GIBSON: No, I didn't say it  
26 was a subsidy. I said they had this fixed rate for  
27 N.H.A. money a good deal of which is provided by  
28 private lenders, and the fact that the rate is relatively  
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DR. EATON: When I say it is a stimulator, I think I am starting from the base that generally their offer for mortgage money has a slight subsidy factor in it. Generally, I think that is true, both in the time of re-payment -- not merely the rate of interest -- but the time of re-payment, and so on, and that you do get in their lending an element of subsidy. I think you are saying this subsidy may be more or less a holder rate until the market goes beyond ---

COMMISSIONER GIBSON: No, I didn't say it was a subsidy. I said they had this fixed rate for N.H.A. money a good deal of which is provided by private lenders, and the fact that the rate is relatively



1 fixed has tended to make the flow of funds through  
2 the N.H.A. somewhat anti-cyclical.

3 DR. EATON: I certainly would not hold  
4 myself up as an authority on this; I may be wrong,  
5 but it certainly is my impression that there is  
6 through the various things -- the guarantee, the term --  
7 an element of subsidy, and that is what I mean by  
8 being generally a stimulator, that you vary through  
9 the period more or less depending on how they hold  
10 themselves. But on balance I would still believe  
11 what I said is generally true.

12 COMMISSIONER GIBSON: Thank you.

13 COMMISSIONER LEMAN: Instead of talking  
14 about the effectiveness of fiscal policy in the  
15 absolute, why don't we talk about it a little bit in  
16 relative terms. You seem to be fairly optimistic  
17 that monetary policy has effectiveness as against  
18 fiscal policy. Let us talk about them in relation to  
19 each other: do you really feel monetary policy,  
20 which people also tell us operates at the margin only,  
21 is more effective or less effective than would be fiscal  
22 measures?

23 DR. EATON: I believe more effective; monetary  
24 policy more effective. The leverage they have got is  
25 so much greater; they have all kinds of power to  
26 be tough, and their instruments are so much more  
27 effective than, in my opinion, the fiscal policy  
28 instruments are, and can operate much more promptly  
29 and efficiently. The timing can be pretty sharp,  
30 whereas the fiscal instruments, by the time you get



fixed has tended to make the flow of funds through  
the N.H.A. somewhat anti-cyclical.

DR. EATON: I certainly would not hold  
myself up as an authority on this; I may be wrong,  
but it certainly is my impression that there is

through the various things -- the guarantee, the term --  
an element of subsidy, and that is what I mean by  
being generally a stimulator, that you vary through  
the period more or less depending on how they hold  
themselves. But on balance I would still believe  
what I said is generally true.

COMMISSIONER LEWIS: Instead of talking

about the effectiveness of fiscal policy in the  
absolute, why don't we talk about it a little bit in  
relative terms. You seem to be fairly optimistic  
that monetary policy has effectiveness as against  
fiscal policy. Let us talk about them in relation to  
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1 this house up and get through a major policy, and  
2 getting it planned to begin with, you may be a year  
3 out of date before you get it working. Generally  
4 I think monetary policy is more important in slowing  
5 hings down. It cannot be very effective in starting  
6 things up.

7 COMMISSIONER GIBSON: On this problem  
8 of timing and the obvious difficulties of changing  
9 fiscal policy quickly, what do you think of the idea  
10 of giving the executive -- the cabinet minister --  
11 certain discretionary powers to change certain sales  
12 taxes within certain planned limits?

13 DR. EATON: Yes, I think so; I would  
14 be in favour of that. But, take the next step and  
15 ask me where you would do it if you had the power.  
16 That is the difficult question to answer.

17 COMMISSIONER GIBSON: But this is the  
18 problem the monetary authorities are faced with.

19 DR. EATON: Meaning they cannot move on  
20 their own?

21 COMMISSIONER GIBSON: Yes, but it is quite  
22 difficult to know when to move.

23 DR. EATON: Oh, yes; you have to be smart and  
24 all wise, which is quite a strain on anybody.

25 COMMISSIONER GIBSON: You think there is some  
26 sense in this approach, that there should be some  
27 discretionary power to change certain types of taxes?

28 DR. EATON: Yes, I think the British are  
29 on sound ground in trying to get that built into  
30 their system, but I can see only one direction where I



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COMMISSIONER GIBSON: You think there is some

sense in this approach, that there should be some discretionary power to change certain taxes at least?

DR. EATON: Yes, I think the British are on sound ground in trying to get that built into their system, but I can see only one direction where I





1 might want to use it, and then I would not be  
2 very enthusiastic about it, and that is on personal  
3 income tax. If you had the power, I think this is  
4 one direction where it could work quickly, and that  
5 is to give the government authority to cease withholding  
6 for, say, two months, and then legislate a one-sixth  
7 reduction tax burden over that year. That is the  
8 kind of thing you could move in quickly on, and I  
9 think it would work. It would be "mussy", but I think  
10 it would work. But, after having done that, I would  
11 turn around and say that one-sixth of this total tax  
12 liability being deducted at the source won't give  
13 you a very big fill-up in spite of your multipliers.  
14 I can't see how they would dare under our system cut  
15 the sales tax out for a month or reduce excise taxes.  
16 You would ruin people doing that. You just can't do  
17 it.

18 COMMISSIONER LEMAN: Dr. Eaton, in paragraph  
19 184 you seem to make the point that fiscal measures  
20 as counter-cyclical measure have very unequal effects.  
21 If you start varying, for instance, the corporate  
22 taxes, you would affect different people differently.  
23 Monetary policy action for some purposes also has  
24 some unequal effects, doesn't it?

25 DR. EATON: Yes, but monetary policy does  
26 not take money out of your hide and turn it into the  
27 treasury so that you never get it back. You may be  
28 slowed down and not make a certain expenditure, but  
29 what I am talking about here is jumping the corporate  
30 tax up 10 per cent or something and taking that money



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COMMISSIONER LAMMAN: Dr. Batton, in paragraph

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DR. BATTON: Yes, but monetary policy does not take money out of your hide and turn it into the treasury so that you never get it back. You may be slowed down and not make a certain expenditure, but what I am talking about here is juggling the corporate tax up 10 per cent or something and taking that money



1 away from every corporation merely because some of  
2 them are moving ahead too fast for capital  
3 expenditure. I think that is very unfair; I don't  
4 think that kind of use of the corporate tax can be  
5 justified.

6 COMMISSIONER LEMAN: Well, for some operations,  
7 if you take away their credit you take away practically  
8 as much as if you took away their money, don't you?

9 DR. EATON: Well, no; you stop them just  
10 in their tracks. They decide not this year, perhaps  
11 next year: "We can borrow more cheaply another year."  
12 But that is frustrating, perhaps, and frustrating their  
13 plans for what they would otherwise do; but you are  
14 not taking money out of their corporate treasury  
15 and turning it into the government.

16 COMMISSIONER GIBSON: If they have assets  
17 like government bonds, monetary policy may very well  
18 whittle away those assets?

19 DR. EATON: But you wait a while and it  
20 will come back.

21 COMMISSIONER BROWN: Maybe it will have the  
22 delayed effect you are looking for.

23 DR. EATON: Yes.

24 COMMISSIONER BROWN: You made the comment that  
25 if sales taxes were changed suddenly you would  
26 ruin a lot of people. What if you change the method  
27 of application of sales tax now that the provincial  
28 governments have set up machinery to put it on at the  
29 retail level? If they were all on at the retail  
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6 the small outlets all over the country, it would probably  
7 work. We may come to that one day.

8 COMMISSIONER BROWN: This would give you an  
9 elastic tax structure that could be changed to meet  
10 short term policies?

11 DR. EATON: Yes, you could change the future  
12 views in the total that was being collected. I do not  
13 suppose you would expect the provinces to go along with  
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15 future.

16 There again I still come back to this  
17 relatively small amount that would be changing; the  
18 total purchasing power of these changes down even at  
19 that level, unless you put in enormous amounts; enormous  
20 changes that would wipe out the whole thing for a period.  
21 You could get into fairly substantial sums. I think  
22 sales tax now is close to a billion, or something of  
23 that order, which is quite a lot of money. If you  
24 wanted to abolish it completely for a whole year or  
25 in periods when things were slow it might help it, yes.

26 COMMISSIONER GIBSON: When you are speaking  
27 of the provinces, would you be prepared to make any  
28 comment about the co-ordination of federal-provincial  
29 spending and tax policies as they relate to the flow of  
30 savings in the country? That is something you have not



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1 dealt with in your memorandum. I realize it is  
2 an enormous subject, but if there is something you  
3 would like to say about it we would be very glad to  
4 hear it.

5 DR. EATON: Oh, I don't know. No, I do  
6 not think I can say much about this.

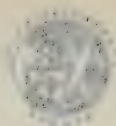
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13 a whole. With our rates as high as they are at the  
14 federal level; 50 per cent to 52 per cent tax, and  
15 the high tax on liquor, tobacco and so on, you could  
16 broaden out your sales tax base, but for the rates  
17 and rate structure I would think there is more scope  
18 for raising tax now much easier with the provinces  
19 than there is today with the federal government.

20 THE CHAIRMAN: Would you specify what you  
21 mean? That is a new view.

22 DR. EATON: I would specify that. I would  
23 say in the province of Ontario they could have put on  
24 a higher sales tax rather than expect money to be  
25 handed down from the federal government. I would  
26 say the same thing for every other province.

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1 DR. EATON: Yes, sir.

2 THE CHAIRMAN: And spread the money among  
3 the provinces with the purpose of helping some province  
4 which the federal government thought needed it. If  
5 the federal government had withdrawn from the cor-  
6 poration tax field the same number of points, period,  
7 and let the provinces increase theirs, if they wanted  
8 to, that would have been perfectly satisfactory, but  
9 the federal government is not giving anything to  
10 anybody.

11 DR. EATON: Well, they have run into a  
12 deficit close to \$3 billion in the amount handed out  
13 to the provinces; by that amount or nearly that amount,  
14 and some day or somehow federal taxes are going up  
15 enough to recapture that and balance the budget. I  
16 am saying here if you put that additional burden  
17 which should go on and has not yet on the federal  
18 structure, it would be easier downstairs.

19 THE CHAIRMAN: The provinces are also running  
20 at a deficit.

21 DR. EATON: Well, I think that all I am saying  
22 sir, is that there is more scope --

23 THE CHAIRMAN: Where do they get the money?

24 DR. EATON: That is right. Both sides  
25 have to have more money. All I am saying is that  
26 without distortion of the tax system it can be  
27 easier obtained at the provincial level in all  
28 provinces. I just mentioned Ontario as an example.

29 THE CHAIRMAN: Oh, I am not sensitive.

30 COMMISSIONER BROWN: Have you looked at one



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1 particular feature which does effect investment, and  
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5 This comes about when there is not a transfer office  
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7 the grass-roots level this does influence investment  
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9 DR. EATON: Let me repeat this. You are  
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11 they retain their own and collect their own and that  
12 they levy a tax on the property passing in the form  
13 of shares when the corporation has a transfer office  
14 in Ontario and Quebec?

15 COMMISSIONER BROWN: And not outside.

16 DR. EATON: And not outside, and the people  
17 in another province will get stuck with inheritance  
18 tax if they die owning shares in Ontario and Quebec?

19 COMMISSIONER BROWN: Against which there is  
20 an offset granted by estates tax, but in many cases  
21 it is not sufficient, and in any event you have legal  
22 problems and so forth to go through.

23 DR. EATON: Yes, it is a troublesome thing.  
24 Well, look, that can be taken care of. That whole  
25 problem can be taken care of so simply, if the person  
26 in the other province would set himself up a little  
27 personal corporation which never dies.

28 COMMISSIONER BROWN: That is what they all  
29 do. That is what they have to do.

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3 DR. EATON: Oh, fairly practical. If you  
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5 hundred dollars will fix you up with a personal  
6 corporation.

7 COMMISSIONER BROWN: That is all right, I  
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9 DR. EATON: So I would not blow that up into  
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11 COMMISSIONER GIBSON: I have one more general  
12 question, Dr. Eaton. You state in your memorandum  
13 that it is desirable to have more savings in Canada.  
14 This is a view that is very widely expressed, and  
15 it is obvious that it is desirable. You also make  
16 it clear that you think it would be desirable to  
17 have larger Canadian ownership of Canadian industry.  
18 Now, to sum up, what in the tax area do you  
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20 said in a number of places that personal income  
21 tax is too high, but you are not sure that is very  
22 important. You say that corporate tax is too high,  
23 but it is passed on. If you were asked, as I am  
24 asking you, what would you do if you could change  
25 these things with a view to increasing savings in  
26 Canada and with a particular view to increasing  
27 Canadian ownership of Canadian businesses and resources,  
28 what would you do then?

29 DR. EATON: I do not know what I would do.

30 COMMISSIONER GIBSON: Where would you put the



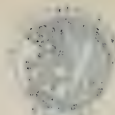


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30 COMMISSIONER GIBSON: Where would you put the



1 emphasis, that is what I mean?

2 DR. EATON: I do not know. I have mentioned  
3 tax credits here as a silly little thing. You could  
4 help with it a little bit. I think mainly this  
5 will have to come gradually, and I think it will  
6 come mainly through corporate acquisitions rather  
7 than anything you do by way of the individual. That is,  
8 Canadian corporations with upstairs money acquiring  
9 Canadian control, but we are in an awful position  
10 in this country, paralleling the United States with  
11 their volume and eye for bargains. It is an awful  
12 problem. I do not know what the answer is, I just  
13 do not. I just know it is not very practical to  
14 put pretty harsh penalties on foreign ownership.  
15 You can do it. There is no doubt about it. With your  
16 tax position you can change withholding rates and  
17 interest on dividends, and you can create real bargains  
18 very quickly with your tax structure. But, good  
19 heavens, if you have not got enough money to take  
20 that up, what happens? You may get a few hundred  
21 millions but where you have got something in the order  
22 of 16 or 18 billions of United States foreign  
23 ownership in Canada and you start putting taxes on  
24 and making a real impact on that you won't get buyers.  
25 It will have to be a slow and gradual process of creat-  
26 ing bargains which you can do quite easily through  
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1 on that they will pull out and you have a crisis on  
2 your hands. This is an awful delicate problem. I  
3 think we are in a position in this country that is  
4 particularly difficult; that is in retaining ownership  
5 with a relatively small amount of capital accumulation  
6 being alongside a border where there is so much venture-  
7 some money and individuals looking for bargains and  
8 good business prospects. I do not know. I have not  
9 got any other suggestions. I just mention that you  
10 can create bargains quite easily through the tax  
11 system.

12 COMMISSIONER GIBSON: Well, do you think  
13 if the personal income tax was graduated to a much  
14 lower top that you might get the sort of marginal  
15 effect increasing savings?

16 DR. EATON: No, I do not think so. Look,  
17 we sit here and say, bring the rate down to 40 per  
18 cent. What have you achieved; \$40 odd million.  
19 Well, shucks, that is not anything in comparison  
20 with the sort of problem we are looking at here in  
21 respect of billions and billions. I do not know.  
22 It worries me. It bothers me but I do not know  
23 what you are going to do about it.

24 COMMISSIONER GIBSON: If you are going to  
25 change it will be a very long and gradual process.  
26 You will not get billions overnight at all.

27 DR. EATON: Just as soon as you start doing  
28 anything with direct investment you have unemployment  
29 on your hands. You have this already, but for a  
30 democratic government to start a policy of that kind



on that they will pull out and you have a crisis on  
your hands. This is an awful delicate problem. I  
think we are in a position in this country that is  
particularly difficult; that is in retaining ownership  
with a relatively small amount of capital accumulation  
being alongside a border where there is so much venture-  
some money and individuals looking for bargains and  
good business prospects. I do not know. I have not  
got any other suggestions. I just mention that you  
can create bargains quite easily through the tax

COMMISSIONER GIBSON: Well, do you think

if the personal income tax was graduated to a much  
lower top that you might get the sort of marginal  
effect increasing savings?

DR. EATON: No, I do not think so. Look,

we sit here and say, bring the rate down to 40 per  
cent. What have you achieved? \$40 odd million.  
Well, snucks, that is not anything in comparison  
with the sort of problem we are looking at here in  
respect of billions and billions. I do not know.  
It worries me. It bothers me but I do not know  
what you are going to do about it.

COMMISSIONER GIBSON: If you are going to

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1 under these conditions does not make too good sense.

2 You are caught and you do not know what to do. I  
3 do not know what to do or what I would do. It is  
4 not very cheerful, but that is the best I can do.

5 THE CHAIRMAN: There is just one question  
6 I want to raise in respect of the section on death  
7 duties. Apparently you think that the one acute  
8 problem arises in the case of a family business that  
9 is worth \$1 to \$2 million, or thereabouts, but it seems  
10 to me that you are regarding the business as being  
11 owned by one proprietor.

12 DR. EATON: Pretty much. I have made that  
13 assumption.

14 THE CHAIRMAN: But isn't that a family  
15 business, and if the ownership is distributed among  
16 the members of the family then the problem becomes  
17 less acute, does it not?

18 DR. EATON: Well ---

19 THE CHAIRMAN: Because they do not all die at  
20 once, unless they are on the same airplane or something  
21 of that kind.

22 DR. EATON: Yes, I see what you mean. No,  
23 I must say I had assumed pretty much a one man ownership.

24 THE CHAIRMAN: Who intends to pass it on after  
25 his death?

26 DR. EATON: That is right.

27 THE CHAIRMAN: Pass it on to the various  
28 members of the family?

29 DR. EATON: Yes. He may have been a little  
30 more foresighted and used the provisions of gift tax





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1 for passing out to the family through gifts or death  
2 arrangements, so that upon his death they would not  
3 get the big impact on one estate, but in a lot  
4 of cases they will pass out debt rather than equity  
5 voting shares for the main part.

6 THE CHAIRMAN: Yes, but it narrows it down  
7 quite a bit?

8 DR. EATON: Yes, it does.

9 THE CHAIRMAN: There are always inequities  
10 of some kind, but this problem can be overcome if  
11 a man thought it out?

12 DR. EATON: That is right.

13 THE CHAIRMAN: And set up some arrangement,  
14 corporate or otherwise, which would ease the position?

15 DR. EATON: Yes, that is right.

16 THE CHAIRMAN: Outside of that one particular  
17 type of case you do not think that death duties are  
18 too troublesome?

19 DR. EATON: Not up to a million or so.

20 I would simplify this. I would assume that  
21 it is fairly easy. Say a business is of a type  
22 where you can get mortgage money on assets. That  
23 might not always be too easy. You may not have the  
24 type of assets that lend themselves easily to mortgage  
25 money, but generally I think it is a fairly reasonable  
26 basis of assumption that this is where you can get  
27 relief, and it makes it awkward from the point of view  
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1 COMMISSIONER BROWN: But throughout you have  
2 made the assumption that this is being done by some-  
3 body who knows what he is doing; he arranges his  
4 life insurance and dividends, and so on, so that  
5 they can get the rest out of the undistributed surplus  
6 by paying the 15 per cent; paying the penalty?

7 DR. EATON: That is right.

8 COMMISSIONER BROWN: But does not the situation  
9 really arise and the problem you discussed in  
10 paragraph 199 where you say:

11 "Some discussion of this problem implies  
12 that the tax somehow favours a take-over  
13 by foreigners. There is nothing in this."

14 DR. EATON: Yes.

15 COMMISSIONER BROWN: I have had accountants  
16 tell me quite frequently that a foreign corporation  
17 can afford to pay a higher price for the surplus  
18 of a company which has not foreseen this problem  
19 and has not put itself in that position, than can  
20 a Canadian corporation, and that this is why a lot  
21 of these companies are sold out to foreigners.

22 DR. EATON: Well, I do not know whether  
23 I would go along with that or not. Well, the purchaser  
24 who plans to run the business, he can create a tax-  
25 free surplus through the 15 per cent depending upon  
26 the part that has accumulated; when it was accumulated  
27 and dividends went out to take care of the other half.  
28 A United States company would pay likewise the 15 per  
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4 person. I agree the reason they are looking for  
5 them is because they have more money and they can  
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7 tax situation that generally gives basis for the  
8 charge that our system here favours the take-over  
9 by non-residents. Perhaps there is a factor in  
10 there, as you say.

11 COMMISSIONER LEMAN: If we might pass on,  
12 Dr. Eaton, to your remarks about credit unions, as  
13 I gather, you say: let us treat them as co-operatives;  
14 let us not make an exception, and by removing the  
15 special treatments we are not going to do them any  
16 harm anyway. That is about your position?

17 DR. EATON: That is right.

18 COMMISSIONER LEMAN: Would you feel that  
19 there is one thing that would have to be paid attention  
20 to, and this is the fact that they do not all finance  
21 the same way province by province? There are some  
22 that are much more share financing and others much  
23 more savings or deposits financing, so that the  
24 incidence of the change could be slightly different,  
25 couldn't it?





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1 DR. EATON: Yes it could, although I don't  
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3 most of them would decide to change the form of paper  
4 which they give out or let it ride and let their  
5 members get a tax credit for the taxes paid upstairs  
6 by their credit union. That would work pretty well  
7 if they were all in income tax, but there may be  
8 some members who are not, but they can recoup even  
9 though the profits are given out in the form of  
10 share ownership, but I do think they would be in trouble --  
11 it seems as if they would in Ontario -- through  
12 the fact that the interest on their savings isn't  
13 a legal obligation; they just decide at the  
14 end of the year how much interest they will pay on  
15 deposits, and I don't think that is a legal obligation  
16 to pay a fixed amount of interest. I don't think  
17 that would be deductible unless they fixed it up,  
18 and that could cause trouble. That would be money  
19 that would go out and never would get a tax credit.

20 COMMISSIONER LEMAN: It would have to be  
21 declared deductible?

22 DR. EATON: That is right, it would have to  
23 come out by the dividend rule in order to qualify  
24 for tax credit; it couldn't go out as interest on  
25 savings -- it could go out, but it wouldn't get a  
26 tax credit.

27 COMMISSIONER LEMAN: One of your arguments  
28 is that there is no reason why any particular class  
29 of institutions should be able, under our tax system,  
30 to build up tax-free reserves?



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1 DR. EATON: That is right.

2 COMMISSIONER LEMAN: Can you think of  
3 any others besides these?

4 DR. EATON: Yes, the banks have the  
5 privilege of a deduction from income for reserves  
6 under the supervision of the Minister of Finance.  
7 I forgot to mention that; I said no others did  
8 have this privilege.

9 COMMISSIONER LEMAN: No others?

10 DR. EATON: I don't know of any others  
11 that have the right to deduction from income for  
12 reserves.

13 COMMISSIONER LEMAN: Well, there were  
14 some mortgage and loan companies that came before us  
15 and made a recommendation that they be given a little  
16 more leeway.

17 DR. EATON: That is right. I remember now  
18 a few years ago the mortgages of certain classes  
19 of companies -- trust and loan companies I think they  
20 were -- they were allowed to set aside each year a  
21 small amount building up to -- I have forgotten what  
22 the percentage is --  $2\frac{1}{2}$  per cent of the value of  
23 mortgages, something like that, as an accumulative  
24 build-up. I had forgotten about this, that is right.

25 COMMISSIONER LEMAN: In general do you  
26 think that is a bad principle; would you be against  
27 such reserves for tax purposes?

28 DR. EATON: I think so. I think so on  
29 the mortgage and loan. I don't know what value there  
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12 are all notice deposits and I don't think that they  
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14 the banks have and they are not as vulnerable as the  
15 banks are to panic.

16 COMMISSIONER LEMAN: These things end up  
17 as a form of incentive again?

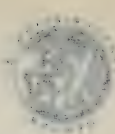
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19 I don't think they are induced to do things because  
20 of this tax-free reserve.

21 COMMISSIONER LEMAN: I wasn't thinking of  
22 credit unions here, but in the case of the mortgage  
23 and loan companies it might be a form of incentive?

24 DR. EATON: They could invest in mortgages  
25 rather than in other directions. It might be a bit,  
26 but it is not important; it is not large, not important.

27 COMMISSIONER LEMAN: I have a question here  
28 which is not very relevant to what we have been  
29 discussing, but since Mr. Gibson had told you that  
30 he had been a little depressed by some of your views





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1 about what can be done about things, there is one  
2 argument which you may make in paragraph 187 that  
3 rather depresses me, and that is that you say that  
4 it seems practically impossible in a lot of  
5 circumstances to judge whether we are in a cost-push  
6 or demand-pull, and if we don't know that we don't  
7 know very much, do we?

8 DR. EATON: No.

9 COMMISSIONER LEMAN: You have answered  
10 me!

11 THE CHAIRMAN: This concludes the discussion.

12 DR. EATON: Thank you, sir.

13 THE CHAIRMAN: We appreciate very much  
14 the paper that you have prepared for us and the  
15 discussion which has ensued.

16 DR. EATON: Thank you very much.

17 THE CHAIRMAN: We will adjourn now until  
18 2 o'clock this afternoon when we shall hear the brief  
19 of the Canadian Chamber of Commerce.

20  
21 --- Luncheon Adjournment.  
22  
23  
24  
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COMMISSIONER LAMONT: You have answered

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--- Luncheon Adjournment.





1 --- Upon resuming at 2 P.M.

2  
3 SUBMISSION OF

4  
5 THE CANADIAN CHAMBER OF COMMERCE

6  
7  
8 APPEARANCES

9  
10 Mr. George Keeping

11 Mr. J. G. Crean

12 Mr. W. J. McNally

13 Mr. H. H. Edmison

14 Mr. J. Strathy

15 Mr. W. A. S. Case

16 Mr. D. Kerlin

17 Mr. W. J. Sheridan

18  
19 THE CHAIRMAN: We will now come to order

20 and we will consider the brief of The Canadian Chamber  
21 of Commerce, and, Mr. Keeping, you are the prime  
22 spokesman for the organization and we would appreciate  
23 it if you would introduce your colleagues.

24  
25 MR. KEEPING: May I just make a few very  
26 short remarks first?

27 THE CHAIRMAN: Certainly.

28 MR. KEEPING: Mr. Chairman and gentlemen,  
29 the executive council of the Canadian Chamber of  
30 Commerce is very grateful for this opportunity to  
express its views to this Commission.



--- Upon resuming at 2 P.M.

MINUTES OF

THE CANADIAN CHAMBER OF COMMERCE

ATTENDANCES

- Mr. George Keeping
- Mr. J. G. Green
- Mr. W. J. McWally
- Mr. H. H. [unclear]
- Mr. J. Stratton
- Mr. W. A. S. Case
- Mr. W. Keating
- Mr. W. J. Sheridan

THE CHAIRMAN: We will now come to order and we will consider the brief of The Canadian Chamber of Commerce, and, Mr. Keeping, you are the prime spokesman for the organization and we would appreciate it if you would introduce your colleagues.

MR. KEEPING: May I just make a few very short remarks first?

THE CHAIRMAN: Certainly.

MR. KEEPING: Mr. Chairman and gentlemen, the executive council of the Canadian Chamber of Commerce is very grateful for this opportunity to



1           You have received copies of the brief in  
2 advance, and the brief is based upon the democratically  
3 approved principles and policies of the Canadian  
4 Chamber of Commerce and is submitted by the executive  
5 council, which is appointed by the National Board  
6 of Directors, the governing body of the Chamber, to  
7 carry on the ordinary business of the Chamber during  
8 the interim between the meetings of the Board.

9           The Canadian Chamber of Commerce, as you  
10 probably know, is a voluntary federation of some 850  
11 Chambers of Commerce and Boards of Trade throughout  
12 the country. 75 per cent of that 850 are members of  
13 Chambers established in communities with populations  
14 of 5,000 or less.

15           The Ad Hoc Committee, which was set up  
16 by the executive council to prepare this submission,  
17 has taken into account and has endeavoured to present  
18 as far as possible the views of the small businessman.

19           You will note that the brief has been  
20 signed by Mr. F. W. Bradshaw, who was the chairman  
21 of the executive council at the time of the preparation  
22 of the submission. We have since had an annual meeting,  
23 and I am now the holder of that position.

24           My delegation is composed of Mr. W.A.S. Case,  
25 who is third from my right, and who is the provincial  
26 director from New Brunswick. Mr. J. G. Crean, a  
27 past president of the Canadian Chamber of Commerce,  
28 and chairman of the ad hoc committee charged with  
29 preparing the submission, is on my right. Mr. J.G.  
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1 Committee is next door but one to me on the left.  
2 Mr. H. H. Edmison, a member of the ad hoc committee,  
3 is next door but one to me on the right, and Mr.  
4 Donald Kerlin is also a member of that committee and  
5 is on the far left. Also on my extreme right is  
6 Mr. W. J. Sheridan, assistant general manager of the  
7 Canadian Chamber of Commerce, and on my left Mr.  
8 W. J. McNally, manager of the Policy Department of  
9 the Canadian Chamber of Commerce.

10 Our submission is founded on the Chamber's  
11 declaration on the Freedom of Enterprise which is  
12 attached as an appendix to the submission. In  
13 particular, the executive council believes that the  
14 economy will be best served by a capital market that  
15 is free, competitive and viable. The submission  
16 expresses a view that the market functions immeasurably  
17 better than any system based on governmental control  
18 of the way the nation's savings are put to work. It  
19 believes that the role of government should be one  
20 of encouraging the system to function more smoothly.

21 At page 3 and following there is summarized  
22 the recommendations that have been made in the  
23 submission. Since you have had the brief in  
24 advance, I don't feel that you would want me to  
25 subject you to a reading of it, although I would be  
26 quite glad to do so should you wish it.

27 THE CHAIRMAN: It is not generally done.

28 MR. KEEPING: I am very glad not to have  
29 to do it, sir, and therefore --

30 THE CHAIRMAN: We have all read it.



Committee is next door but one to me on the left.  
Mr. H. H. Edmiston, a member of the ad hoc committee,  
is next door but one to me on the right, and Mr.  
Donald Kertin is also a member of that committee and  
is on the far left. Also on my extreme right is  
Mr. W. J. Sheridan, assistant general manager of the  
Canadian Chamber of Commerce, and on my left Mr.  
W. J. McNelly, manager of the Policy Department of  
the Canadian Chamber of Commerce.

Our submission is founded on the Chamber's  
declaration on the Freedom of Enterprise which is  
attached as an appendix to the submission. In  
particular, the executive council believes that the  
economy will be best served by a capital market that  
is free, competitive and viable. The submission  
expresses a view that the market functions immeasurably  
better than any system based on governmental control  
of the way the nation's savings are put to work. It  
believes that the role of government should be one  
of encouraging the system to function more smoothly.

At page 3 and following there is summarized  
the recommendations that have been made in the  
submission. Since you have had the brief in  
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1 MR. KEEPING: --- with these opening words  
2 we are in your hands to pose any questions you may  
3 wish to. I would like to say that I, in my capacity  
4 as chairman of executive council, do not hold myself  
5 out in any way as an expert in this field, and I  
6 would hope that you would permit other members of  
7 the delegation to take part in it.

8 THE CHAIRMAN: Certainly. We will proceed,  
9 then, with the discussion.

10 COMMISSIONER GIBSON: I will ask a few  
11 general questions. I would like to ask a few questions  
12 about your views on the capital market.

13 You make a number of general statements as  
14 to the sort of capital market we should have. Mr.  
15 Keeping, you just read a statement that the executive  
16 council believes that the economy will best be served  
17 by a capital market that is free, competitive and viable.  
18 Later you say that the executive council believes  
19 that the present deficiencies in the capital market  
20 can be remedied so as to make it function even more  
21 efficiently than it does now. Later on page 11 you  
22 refer to gaps in the capital market, and you say:

23 " ... that when government intervenes in  
24 the functioning of the financial system,  
25 it should do so with the objective of  
26 improving the functioning of that system  
27 and filling gaps in it that need to be  
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1 Then at page 13 you go on to say that the government  
2 shouldn't go too far in this area; that they tend to  
3 do little more than fill the gaps at times, and that  
4 private arrangements are the most desirable.

5 I wonder if you would elaborate a little  
6 on what are the deficiencies in the capital market  
7 and how you think you can make it work better?

8 MR. STRATHY: Mr. Commissioner, I think  
9 what we have really ended up by saying is that these  
10 gaps are now being possibly filled to a better  
11 extent by private enterprise corporations than was  
12 the case earlier.

13 For example, RoyNat Corporation and the  
14 Canadian Enterprise Development Corporation Limited,  
15 which has been a development -- the latter one  
16 particularly -- which perhaps hasn't started operating  
17 yet, but it is in a development which has acted  
18 quite reasonably and we feel that these are the  
19 kind of private enterprise organizations for which  
20 there has long been a need and which should pro-  
21 vide a very useful function in the capital market.

22 In conjunction with that, we are talking  
23 about the Crown corporations in this area, and, as  
24 we have said in our brief, we feel that they should  
25 fill gaps that are not always filled by private  
26 enterprise, but not to continue operating on a very  
27 vigorous basis if a private corporation has come in  
28 subsequently and appears to be starting to or filling  
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1 COMMISSIONER GIBSON: Are you suggesting  
2 that a Government organization should be willing to  
3 fill a gap on better terms than a private institution would?

4 MR. KEEPING: Yes, that is right.

5 COMMISSIONER GIBSON: We have heard, for  
6 example, some suggestions that the Industrial  
7 Development Bank is too active / competing with some private businesses.  
8 What are the criteria for competition between a government  
9 company and private business? What is reasonable and  
10 what is not?

11 MR. KEEPING: Perhaps Mr. Strathy would  
12 answer that question.

13 MR. STRATHY: One aid the government  
14 institutions have had is that they have been able to  
15 acquire money for their funds for their development  
16 programmes at a much lower cost than would be  
17 available to a private corporation which has to go  
18 into the money market and pay the going rates. That  
19 is a good thing if these gaps have to be filled,  
20 but this kind of corporation in a sense is being  
21 subsidized if the gap is filled by a private enter-  
22 prise corporation.

23 COMMISSIONER GIBSON: When you are speaking  
24 of gaps you refer specifically to two companies in  
25 the area of, particularly, equity-capitalized new  
26 industries. You think there is a gap that  
27 needs filling. Are there any other areas that you  
28 feel are not adequately serviced at the present  
29 time?

30 MR. STRATHY: I suppose it is perfectly fair



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1 to say that small companies -- and perhaps it is hard  
2 to define what a small company is -- have difficulties  
3 in raising capital whereas large companies can go  
4 to the public through the normal routine investment  
5 dealers if their credit standing is satisfactory.  
6 They can also bear the cost of the financing of raising  
7 capital, and this area has not been so readily open  
8 to the small company.

9 I should think that is the area which needs  
10 to be studied and where there is a need for capital  
11 corporations like the Industrial Development Bank or  
12 within newly-formed organizations, which I am not sure  
13 we are entirely familiar with as to how they are going  
14 to function. Presumably they are going to lend money  
15 and also put up equity money. If they do do that it  
16 seems to me they could apply those talents both  
17 to companies that have been in operation for some  
18 considerable time and to new companies.

19 There would still be lots of companies  
20 outside the workings of these private corporations,  
21 so presumably there would still be gaps.

22 COMMISSIONER GIBSON: But there is no other  
23 particular one you want to emphasize at this time?

24 MR. EDMISON: Perhaps one should add, Mr.  
25 Commissioner, that there are always going to be gaps  
26 in a general sense that will develop. For instance,  
27 one would be in the capital social area, and in other  
28 types of, shall we say, private enterprise capital.  
29 I do not think that what has been suggested here  
30 in the social capital area where, as we all know,



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1 the Central Mortgage and Housing Corporation has been  
2 useful and effective in helping to provide funds in  
3 that area in co-operation with other bodies such  
4 as municipalities and provinces. I think what was  
5 intended to be stressed here is that in the areas  
6 which are considered to be more in the private sector,  
7 these gaps can perhaps be more properly filled  
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9 The Chamber welcomes the introduction of  
10 these new corporate bodies and hopes there will be  
11 more. This is without prejudice, of course; I think  
12 in expressing a personal opinion of the activities  
13 of the Industrial Development Bank, which moved into  
14 a specialized area in their field.

15 COMMISSIONER GIBSON: Have you any views  
16 about the supply of capital to business in Canada?

17 MR. EDMISON: I would think, Mr. Commissioner,  
18 one has to look at it at the level of the over-all  
19 capital investment and the policy to muster the savings  
20 to meet that investment. For example, in the current  
21 year the over-all estimate of capital formation in  
22 Canada is 8.7 billion dollars. In all likelihood  
23 the savings are not available even in this country  
24 to meet such a level of capital outlay without calling,  
25 let us say, on some capital or savings from outside  
26 the country, which of course has been our pattern  
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1 them at any given time.

2 COMMISSIONER GIBSON: I take it you are not  
3 content with the present level of savings?

4 MR. EDMISON: No, I would not think so.

5 COMMISSIONER GIBSON: I take it the Chamber  
6 does not have any strong view on the import of capital?  
7 You say that the import of capital should not be  
8 discriminated against.

9 MR. EDMISON: That is right.

10 COMMISSIONER GIBSON: That is the only  
11 statement I see in the brief on that.

12 MR. EDMISON: I think it is a recognition  
13 of the fact that we have for quite a long time relied  
14 on foreign savings to finance part of our capital  
15 programme, and we cannot envisage any change in that  
16 pattern.

17 COMMISSIONER GIBSON: With respect to your  
18 recommendations, your first recommendation is:

19 "That the role of government be to  
20 encourage the private competitive  
21 economic system to function more  
22 smoothly."

23 Would you elaborate a little bit on  
24 this?

25 MR. STRATHY: I think we get down to the  
26 area of government debt creation and the function of  
27 the financial community. Is that the area in which  
28 perhaps your question is related?

29 COMMISSIONER GIBSON: Yes.

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MR. STRATHY: It would seem to me that in





1 this matter of raising capital there has to be the  
2 closest co-ordination between the money managers --  
3 the Bank of Canada and the Department of Finance --  
4 and the financial community to ensure that the vehicle  
5 which is put out for the public is acceptable to  
6 the public. In my view, and perhaps it is a personal  
7 view because of the industry I am connected with, this  
8 liaison has very considerably improved in late months,  
9 perhaps since the development of the crises in June.

10 I think there is very real improvement:  
11 The fact that the Bank of Canada and the Department  
12 of Finance are calling down to Ottawa experts who  
13 are going to visit in the main financial centres and  
14 feel the pulse, seems to me, is something that is  
15 productive of the best results in raising new capital,  
16 at least in the Federal scene. We in the Chamber  
17 of Commerce feel that this could well be formulized  
18 perhaps now or at a later date. If I could draw an  
19 analogy with the provinces: in this particular area  
20 certain provinces for years have appointed fiscal  
21 agents or they have sought the counsel of all the  
22 money raisers to guide them in drawing up and designing  
23 the best medium to raise their financial requirements.  
24 Now, the Federal Government naturally cannot appoint  
25 fiscal agents, but it seems to me they could take a  
26 leaf out of the pattern in the United States whereby  
27 leading financial men in the community are on call  
28 from Washington, the Federal Reserve, and do go down  
29 to Washington from time to time and are taken into  
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1 I think from that, sound advice is obtained and  
2 practical results achieved. Of course, the two  
3 countries are not similar in all respects, but the  
4 Chamber feels that this kind of a development is in  
5 the best interests of this matter of raising capital.

6 We want to make the point that perhaps  
7 stemming from agitations of this kind, this development  
8 is now coming along very nicely and much more  
9 satisfactorily than it used to. If I may continue  
10 with my remarks, in the 1958 conversion loan, for  
11 example, I would say at this time -- and this is  
12 perhaps citing an example -- the investment fraternity,  
13 and perhaps the institutions too, were faced with a  
14 fait accompli and were called down to Ottawa and  
15 closeted with the authorities and told that 50 per cent  
16 or 60 per cent of the outstanding government loans  
17 would be refunded in that vast refunding at that time.

18 Well, perhaps because of other factors  
19 that action was not all that successful. It was too  
20 big and took too long, and of course money markets  
21 changed during the interim. But it might have been  
22 very much more successful on a smaller basis, which  
23 I say might have been the advice of the experts in  
24 the financial area where those securities had to be  
25 sold.

26 COMMISSIONER GIBSON: You are in effect  
27 saying the government should get good advice and  
28 sound out expert groups on major matters of finance  
29 policy. Your first recommendation reads:

30 "That the role of government be to



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COMMISSIONER GIBSON: You are in effect

saying the government should get good advice and sound out expert groups on major matters of finance

"That the role of government be to



1 encourage the private competitive economic  
2 system to function more smoothly."

3 To go a little further, I just wondered  
4 if you could give us a general idea of what you mean  
5 by that? Does that mean that the Canadian Chamber  
6 of Commerce is in favour of a basically anti-cyclical  
7 monetary and fiscal policy?

8 MR. KEEPING: No, I do not think it  
9 necessarily indicates that. This is a general  
10 recommendation which is a preface, really, to most  
11 of our other recommendations. It reflects an appreciation  
12 by us that government has a role to play in the economy,  
13 something which perhaps was not recognized to the  
14 same extent some 20 or 30 years ago. In these days  
15 of high competition in the trading world I think we  
16 recognize that government has a role to set the climate  
17 for the economy, and I think that requires a close  
18 form of co-ordination of the various government  
19 departments, such as the Department of Finance and  
20 the Department of Trade and Commerce, and so forth.  
21 The government has this role of setting the climate  
22 to enable business under the private enterprise system  
23 to make the progress it should make. This is a  
24 general sort of statement without bearing in mind  
25 any specific things such as anti-cyclical budgeting,  
26 and so on. It is merely a recognition by us that the  
27 government has a greater role to play than it has  
28 perhaps had in the past.

29 We feel that the government should give  
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1 word "planning" because I do not mean it in the  
2 form of economic planning in the socialist sense, but  
3 to give thought to providing a suitable climate for  
4 business to flourish, and in our opinion that necessitates  
5 a more energetic degree of co-ordination within the  
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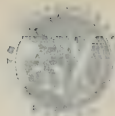
7 COMMISSIONER GIBSON: Yes; but would not a  
8 reasonable policy for providing a favourable economic  
9 climate involve combating depression on the one hand  
10 and inflation on the other hand?

11 MR. KEEPING: Oh, certainly. I was not  
12 denying that. I wanted to point out that the terms  
13 of that recommendation were in general terms. I  
14 agree with you.

15 MR. EDMISON: Perhaps Commissioner Gibson  
16 is pressing on, to some extent, into recommendation  
17 No. 2, dealing with co-ordination.

18 COMMISSIONER GIBSON: That is true.

19 MR. EDMISON: You could, of course, have  
20 a set of circumstances develop where the fiscal  
21 policy of the government at a given time -- and we  
22 are not saying inappropriately -- has run into  
23 substantial deficits and, in the financing of these  
24 deficits through the debt management operations, they  
25 have in effect preempted the savings for that purpose,  
26 and it is quite conceivable that unless this operation  
27 were conducted with great skill it could have  
28 some dislocating effects or might not leave enough  
29 room for financing not only in the private sector  
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1                   We are simply saying in that particular  
2   respect co-ordination is vital, and one could of  
3   course use the same kind of argument in respect to  
4   the exchange rate policy, which must be harmonious  
5   with the monetary policy, and the role that the commercial  
6   policy should play, and so on. But there are a great  
7   number of examples to show how important co-ordination  
8   is.

9                   COMMISSIONER GIBSON: Are there any  
10   particular ways you think this should be done, or  
11   areas where it could be improved? Mr. Strathy  
12   mentioned one when he talked about financial plans.

13                  MR. EDMISON: You mean suggestions with  
14   respect to personnel?

15                  COMMISSIONER GIBSON: Well, how government  
16   policies could be better co-ordinated? This is  
17   obviously a good idea. Have you any specific thoughts?

18                  MR. EDMISON: I think it is specific in  
19   recommendation No. 3 that the government, in relation  
20   to monetary policy, on which there has been some  
21   confusion or concern in the past, has to be responsible  
22   for it, at least at a given time, and it must be  
23   recognized that government is responsible not only  
24   for fiscal policy but for exchange rate policy and  
25   debt management policy, and also responsible in the  
26   final analysis for monetary policy and must make it  
27   possible at least for that kind of co-ordination.  
28   If you have not got that, then obviously you have not  
29   got co-ordination or you are in great danger of  
30   having some schizophrenia in the area.



Mr. Strathairn: I am not sure that

respect co-ordination is vital, and one could of course use the same kind of argument in respect to the exchange rate policy, which must be harmonious with the monetary policy, and the role that the commercial policy should play, and so on. But there are a great number of examples to show how important co-ordination is.

COMMISSIONER GIBSON: Are there any

particular ways you think this should be done, or areas where it could be improved? Mr. Strathairn:

mentioned one when he talked about financial plans.

MR. EDMISON: You mean suggestions with

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having some schizophrenia in the area.



1 COMMISSIONER GIBSON: In other words, you  
2 would like to define the responsibility more clearly?

3 MR. EDMISON: I think that is the intent  
4 of recommendation No. 3.

5 COMMISSIONER GIBSON: Before we go on  
6 to deal with recommendation No. 3, in addition to  
7 the things you mentioned there are other areas of  
8 economic policy. I wonder about housing, for example.  
9 Do you think the housing policy is near enough to  
10 the monetary, debt and exchange policies? We have  
11 listened to representatives of the Central Mortgage  
12 and Housing Corporation  
13 and I got the impression that they felt they were doing  
14 a housing job and are not part of the anti-cyclical  
15 apparatus. But I would think it does affect them  
16 to some extent.

17 MR. EDMISON: In practice it has, has it  
18 not, partly because of their rate structure.

19 COMMISSIONER GIBSON: Yes. Do you think  
20 in terms of a rather broader co-ordination than  
21 simply monetary, fiscal and exchange policies?

22 MR. KEEPING: I think so, a broader  
23 co-ordination with trade and commerce in particular.  
24 We have more or less confined this to the monetary  
25 and fiscal and financial aspects as a matter before  
26 this Commission.

27 COMMISSIONER GIBSON: The trouble is that  
28 things like housing involve interest rate and you  
29 may get into the same area.

30 MR. KEEPING : Yes.



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MR. KEEPLING: Yes.





Nethercut & Young

Toronto, Ontario

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1 COMMISSIONER GIBSON: Moving on  
2 to recommendation No. 3, it reads:

3 "That the Bank of Canada Act be  
4 amended so as to give the government the  
5 authority to issue broad directives to the  
6 Bank of Canada on over-all monetary policy."

7 How would these directives be given, when  
8 there is a difference between the Bank of Canada  
9 and the Minister of Finance, or would they be given  
10 regularly as a guide to operations of the Central  
11 Bank? What is your thinking?



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1 MR. KEEPING: My own view is that they  
2 would be given as guides to policy. Obviously, the  
3 Bank of Canada is contemplated as being there to  
4 carry out the day-to-day business, and it should  
5 not be interfered with so far as that is concerned,  
6 but it may be necessary from time to time -- and  
7 probably will -- for the government to give it direction  
8 to see that the monetary policy it is carrying out  
9 is in keeping with the fiscal and commercial policy  
10 of the government. However, I do not think we had  
11 in mind any regular directives being issued once a  
12 month or once a week, and so on. This is merely  
13 a general recommendation that the government ensure  
14 that the monetary policy being carried out by the  
15 Bank of Canada is in line and is co-ordinated with  
16 the government's fiscal and commercial policy.

17 COMMISSIONER GIBSON: But you would see  
18 these directives as directives that might, in fact,  
19 be issued from time to time, rather than this being  
20 a power held in reserve by the government in case  
21 there was a fundamental difference in policies?

22 MR. KEEPING: Well ---

23 COMMISSIONER GIBSON: You see, some people  
24 have suggested that there should be directives issued  
25 at regular intervals telling the Bank of Canada the  
26 direction in which it should move. Others have  
27 suggested that there should be only a power of  
28 directive, which power is to be exercised only when  
29 there is a fundamental difference.

30 MR. CREAN: Mr. Commissioner Gibson, during





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MR. KEEPLING: I am not sure, are people



1 the discussion we had when we were putting together  
2 this brief one thing came up, namely, that in years  
3 gone by, as I am sure you are aware, the separation  
4 of monetary policy from the government's policy,  
5 especially in England, was very direct. It was a  
6 kind of a brake on political policies, in the same  
7 sense as the House of Lords in years gone by may have  
8 been a brake. We have started out with a proposition  
9 that, after all, parliament is supreme, and we came  
10 to the conclusion that there should be more co-  
11 ordination between various sections of the government  
12 for the good of the country. Therefore, in the long  
13 run, or in any crisis, the government has to be supreme  
14 in seeing that whatever it considers its monetary  
15 policy is carried out. That has nothing to  
16 do with the day-to-day policies of the Bank of  
17 Canada. But, we felt that as parliament is supreme  
18 the Bank of Canada, therefore, would be in an invidious  
19 position if it should in its own wisdom feel it should  
20 prolong a delaying tactic over too long a period which  
21 would run fundamentally counter to the economic  
22 policies of the government.

23 THE CHAIRMAN: I see your point very well.  
24 You do not want to be specific about whether it is  
25 a power that should be held in reserve, or a power to  
26 be used only once in a while to indicate the line  
27 of policy?

28 MR. CREAN: I think if you are going to have  
29 co-ordination it cannot be a power that is held in  
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reserve all the time.





1 THE CHAIRMAN: There would be less reason  
2 for disagreement if it is a power held in reserve.  
3 That is the argument, in any event.

4 MR. KEEPING: If I may quote from page 7  
5 of our brief, Mr. Chairman, we did say:

6 "This matter should be clarified,  
7 and the Executive Council recommends  
8 that the Bank of Canada Act be amended  
9 so as to give the government of the  
10 day the authority to issue broad  
11 directives to the Bank of Canada on  
12 overall monetary policy when the views  
13 of the government are contrary to the  
14 Bank's policies."

15 Does that answer your question?

16 COMMISSIONER GIBSON: You are really  
17 suggesting a sort of reserve power?

18 MR. EDMISON: Logically, in practice, if  
19 you have active consultation, that is what would be  
20 the case. That is, it is a power that exists, and  
21 it is very clear, and the ultimate responsibility  
22 is known, but if you have consultation going on all  
23 the time then it is very unlikely that that kind of  
24 directive ---

25 COMMISSIONER GIBSON: It has not been  
26 used in England, and yet the power is there. Those  
27 are all the questions I have, Mr. Chairman.

28 COMMISSIONER BROWN: Can I ask one question?  
29 Do you visualize this directive, if it is issued,  
30 as being a public matter subject to debate in parliament?



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COMMISSIONER BROWN: Can I ask one question?

Do you visualize this directive, if it is issued,

as being a specific power, or as being a general power?



1 MR. CREAN: I think if it was issued, and  
2 it was not carried out, there would not be much else  
3 for the Governor of the Bank of Canada to do but  
4 resign, and if he did resign he would be free to give  
5 his reasons for so doing.

6 COMMISSIONER BROWN: Let us assume that  
7 he does not resign. Let us assume that the Governor  
8 is against it, but he feels it is something that he  
9 must carry out. Should this then be a public matter?

10 MR. CREAN: In our recommendations we  
11 suggest there should be from time to time -- and  
12 rather more frequently than has been the case in the  
13 past -- some information given in the annual report,  
14 and given to the financial press which can then dis-  
15 seminate it rather more widely in the country. I  
16 would think that in a case like this after a certain  
17 time had passed that the reasons for the adoption of  
18 certain policies would be given.

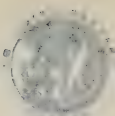
19 COMMISSIONER BROWN: It should be made  
20 public, but not until after the event?

21 MR. CREAN: That is our thinking, but  
22 not necessarily each year. That could be much too  
23 long a period.

24 COMMISSIONER BROWN: How long a period do  
25 you visualize?

26 MR. CREAN: I think that rather depends  
27 on -- I think you would have to let this build up of  
28 itself. It may turn out to be a statement every three  
29 months. I do not think we say in our brief that  
30 there should be any particular time.





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1 MR. McNALLY: I think the Commissioner is  
2 talking about the statement.

3 MR. CREAN: Are you talking about at a time  
4 of crisis?

5 COMMISSIONER BROWN: No.

6 MR. CREAN: I am not familiar enough with  
7 monetary policy to answer this question authoritatively,  
8 but I do read, as a layman, the annual reports of  
9 the Bank of Canada with a great deal of interest, and  
10 I would still read them if some kind of a report was  
11 made every three months.

12 COMMISSIONER BROWN: There is still some  
13 slight distinction here because you spoke earlier  
14 about the fact that parliament has to be in control  
15 of monetary policy. If it is the government that is  
16 initiating this directive, then that is not always debatable  
17 in parliament.

18 MR. CREAN: But it can come up indirectly.  
19 If there is a statement made it can be debated in  
20 parliament.

21 COMMISSIONER BROWN: That is my point.  
22 How soon after the event do you wish this document  
23 to be made public so that parliament can debate it?

24 MR. CREAN: I am speaking personally now,  
25 if I may ----

26 COMMISSIONER BROWN: I do not know whether  
27 the Canadian Chamber of Commerce has discussed this  
28 point.

29 MR. CREAN: --- in saying that there are  
30 a great many things that can come up in monetary policy



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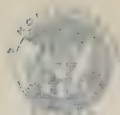




1 on which it would not be for the good of the country  
2 to have statements made immediately by the Governor  
3 of the Bank of Canada. I think most of us here  
4 realize that. I think this would be more in the  
5 way of an attempt to educate more Canadians in the  
6 problems of monetary and fiscal policy than are  
7 interested in it at the present time. I do not think  
8 anyone here -- and neither does the Chamber -- visualizes  
9 that these reports should come out within a week,  
10 or two weeks, or three weeks. I think the matter  
11 all depends upon the type of crisis involved.

12 MR. CASE: Mr. Chairman, may I say just  
13 this, that we seem to have gotten off the main issue  
14 here. I, too, am speaking personally and I have not  
15 had an opportunity of discussing this, but are we  
16 not involved in the area of a financial crisis where  
17 monetary policy has run afoul of what government  
18 policy is in the fiscal way? It is the question of  
19 a directive being then given by the government which  
20 directive would override the policy which has been  
21 laid down as monetary policy by the Bank of Canada.

22 Going further into Mr. Crean's suggestions,  
23 it would be a very wonderful thing if it were possible  
24 for the Bank of Canada to disseminate the type of  
25 information which would be useful to mere laymen such  
26 as ourselves and which would help us to understand  
27 exactly what is behind it all. But, again, we are  
28 in the realm of where I do not think we can ever  
29 hope to attain a full understanding of monetary policy.  
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1 in, is it not, Mr. Crean?

2 MR. CREAN: Yes. I do not think, in a  
3 case where the directive is given in a crisis, that  
4 you can immediately reveal that crisis. I think  
5 it might be very disastrous if you did.

6 MR. CASE: But any suggestion that it be  
7 done on the basis of one month, two months or three  
8 months could again dissociate the two functions.

9 MR. EDMISON: Of course, you could have  
10 conflict without having a crisis.

11 MR. CASE: Yes, you could, but let us  
12 make those words synonymous.

13 COMMISSIONER LEMAN: I am afraid I am more  
14 confused than I was before we started. Let us go  
15 back to your own statement on page 7:

16 "...the Executive Council recommends  
17 that the Bank of Canada Act be  
18 amended so as to give the government  
19 of the day the authority to issue  
20 broad directives to the Bank of Canada  
21 on overall monetary policy ..."

22 Now, if there had been a full-stop there, that  
23 might mean one thing, but you go on to say:

24 "...when the views of the government  
25 are contrary to the Bank's policy."

26 What I believe Mr. Brown and Mr. Gibson  
27 were trying to get from you gentlemen is: When the  
28 views of the government are contrary to the Bank's  
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MR. GREEN: Yes. I do not think, in a

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1 directive, do you want the public to know what the  
2 contention is between the two? That is a clear  
3 question, is it not?

4 MR. KERLIN: Certainly it is a clear  
5 question, but it is a little difficult to give a  
6 clear answer to it. I do not think it is possible  
7 for the Chamber of Commerce as a body to express an  
8 opinion as to a definite time when such information  
9 should be released to the public generally. I  
10 think it must be the government that has to decide  
11 that. If we were to answer such a question we would  
12 be setting ourselves up as having great discernment.

13 As I recall the deliberations of the  
14 Committee at the time this was made up early last spring,  
15 there was a matter that was prominently in front of  
16 us at that time, and maybe our submission has been  
17 to some extent influenced by the condition that  
18 existed between the Bank of Canada and the government  
19 at that time. However, I really think it would be  
20 unfair to ask the Chamber to define what should be  
21 expected. Its feeling is that the public should be  
22 informed at some suitable time.

23 THE CHAIRMAN: I suppose that it implies  
24 also that the differences between the government and  
25 the Bank should be resolved, and that in order to  
26 accomplish that the government should clarify its  
27 position and inform the Bank of what the policy must  
28 be?

29 MR. KERLIN: Without any hesitation whatsoever.

30 THE CHAIRMAN: Yes, and you are not in a



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MR. KERLIN: Without any hesitation whatsoever.

THE CHAIRMAN: Yes, and you are not in a





1 position to recommend any formula or any particular  
2 method of doing that? That is a matter of mechanics  
3 rather than principle.

4 MR. KERLIN: That is right.

5 COMMISSIONER BROWN: There is a point here,  
6 though, on which I would like to get some clarification,  
7 and it is this: In your opinion, do you think there  
8 should be something in the statute with respect to this?  
9 When the Act is amended, should the amendment mention  
10 the time interval beyond which the government must  
11 not go without making a matter public? You are not  
12 prepared to say what that time interval should be,  
13 but do you think it should be statutory, or do you  
14 think it should be left to the government of the day  
15 to make the decision?

16 MR. KERLIN: Subject to what our chairman  
17 has to say, I will say that certainly our discussion  
18 at that time did not contemplate that. Is not that  
19 correct, Mr. Crean?

20 MR. CREAN: Yes. I, for one, would  
21 hesitate to put a time limit on it. I think you  
22 would run into considerable difficulties if you did.

23 MR. STRATHY: I think that is the  
24 responsibility of the government. The government,  
25 after all, is paramount, and monetary policy must be  
26 complementary to government policy or fiscal policy,  
27 and in the final analysis the government has to lay  
28 down the law if there is conflict. But, I do not  
29 think we ever contemplated that that had to become  
30 a public issue within any specific time.



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1 COMMISSIONER BROWN: Then, at no time does  
2 it become a public document.

3 MR. STRATHY: It might not; that is right.

4 MR. EDMISON: It is permissive.

5 MR. STRATHY: It would have to become a  
6 public document definitely if a row broke out; otherwise  
7 it might never get to the public's hearing.

8 COMMISSIONER LEMAN: One wonders what you  
9 think the Bank can do that a subdivision of the Finance  
10 Department cannot do. It is responsible to the Minister  
11 of Finance.

12 MR. STRATHY: But it is responsible for  
13 monetary policy and the practice of monetary policy,  
14 which is not a function of the Finance Department.

15 COMMISSIONER LEMAN: You say it is not,  
16 and I ask you why it is not?

17 MR. STRATHY: Because it is a science in  
18 the realm of that of a central bank.

19 COMMISSIONER LEMAN: What I am driving at  
20 is whether you are placing the bank practically in  
21 the same position as a subdivision of the Finance  
22 Department, responsible to the Minister of Finance?

23 MR. STRATHY: No, I do not think so.

24 MR. CREAN: I think one of the things that  
25 formed the background of this thinking was the concern  
26 that it might be possible at some future date that the  
27 government of the day might neglect to adopt certain  
28 policies which afterwards it could say was not its  
29 ultimate responsibility. I hope I am making myself  
30 clear. If this was changed the government would have





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1 to bear ~~the~~ responsibility, and would indubitably have  
2 the ultimate power as to what the monetary power  
3 should be. I think at times there has been at least  
4 conflict as to where the element of power lay in the  
5 past few years. There has been that confusion  
6 that led to this recommendation, the recom-  
7 mendation being that the government do have the  
8 ultimate responsibility for monetary policy over  
9 the long run.

10 COMMISSIONER LEMAN: I would like to go back  
11 to your recommendation number 4, gentlemen. You have  
12 already talked a little bit about this, but you did  
13 not get down to any concrete considerations relating  
14 to it. What is it specifically that you have in  
15 mind here? You say that there should be established  
16 an advisory body of financial people on whom the  
17 government might call for advice on the technical  
18 aspects and effects of the government's operation  
19 in the financial market. Do you have in mind a  
20 body appointed by the government?

21 MR. STRATHY: Yes.

22 MR. EDMISON: Yes.

23 MR. STRATHY: We have in mind a body  
24 appointed by the government made up of people who are  
25 in the day-to-day management of, and who run, the  
26 financial affairs of the country. Such people would  
27 be appointed, and they would come down to Ottawa on  
28 call.

29 COMMISSIONER LEMAN: On call?

30 MR. STRATHY: Yes, either regularly or on



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2 COMMISSIONER LEMAN: How often?

3 MR. STRATHY: We did not define whether  
4 they should come to Ottawa regularly, or whether they  
5 should be called upon when required, particularly  
6 when new financing is to be undertaken. Those financial  
7 people might conceivably be people in insurance  
8 companies and other organizations which are the  
9 ultimate institutional buyers and who are the pro-  
10 viders of the savings of the people, as it were.

11 COMMISSIONER GIBSON: This is a different  
12 proposal from that of the Investment Dealers' Association,  
13 I take it. They proposed some kind of an advisory  
14 council whose duties would be related more to the  
15 financing of new issues.

16 MR. STRATHY: The Investment Dealers'  
17 proposal is largely that of an advisory body composed  
18 of investment dealers, is it not?

19 COMMISSIONER GIBSON: That was my impression,  
20 but I just wanted to be sure.

21 MR. STRATHY: I would say that in the view  
22 of the Canadian Chamber of Commerce this body would  
23 be broader than that. We envisage a body composed of  
24 people in the financial community at large, and that  
25 is why I mentioned insurance companies and trust  
26 companies, et cetera. I do not include the banks  
27 because I think they are, perhaps, in a different area.  
28 In our discussion this financial group appeared to be  
29 made up of people in the financial area outside of  
30 the chartered banks.



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1 THE CHAIRMAN: Do you contemplate two  
2 separate advisory councils -- one as proposed by the  
3 Investment Dealers, and one as proposed by the  
4 Canadian Chamber of Commerce?

5 MR. STRATHY: I can put two hats on. Putting  
6 on the one hat I will say that in the discussions  
7 we had with a group of people who were not, in my  
8 opinion, all in the financial business, it appeared  
9 that this suggestion is wider than that of the  
10 Investment Dealers.

11 COMMISSIONER BRWON: Were the banks in  
12 this group you discussed this with?

13 MR. STRATHY: Yes, they were.

14 COMMISSIONER LEMAN: In other words, you  
15 are suggesting that it would be good if the govern-  
16 ment got into the habit of seeking information on  
17 the street, in a sense?

18 MR. CREAN: Yes.

19 COMMISSIONER LEMAN: Why formalize this  
20 whole thing?

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MR. GREEN: Yes.

COMMISSIONER LEMAN: Why formalize this

whole thing?



MR. CREAN:

1 Because, in a time of crisis -- or, shall we say that  
2 we had been through a crisis to a certain extent. It  
3 is working pretty well now, not perhaps on this  
4 particular group of financial people I am talking about,  
5 but there is a liaison going on now in the financial  
6 community and Ottawa. I would say that the financial  
7 community would tend to think when the situation got  
8 back to normal, if there is such a thing as normal --  
9 quieter than it has been -- that these methods that  
10 are now being effected might die down again and  
11 we might get away from this liaison situation which  
12 is developing so well at the moment and therefore  
13 formalizing; then it has to be done.

14 COMMISSIONER LEMAN: I am just trying to  
15 visualize how this body would work; how it would  
16 be constituted and how the government would proceed  
17 to appoint people to it and fire them off it when  
18 it does not like the advice it is getting. What do  
19 you have in mind really?

20 MR. STRATHY: Well, I would think actually  
21 if it got down to reall workability it would be a  
22 committee; an official committee of financial people  
23 who would be in the top category of financing; the  
24 top executive officers of financial institutions,  
25 but from there on their deputies, or the more practical  
26 working people in those particular financial areas  
27 might work with their opposite numbers in the  
28 finance department of the Bank of Canada for the  
29 actual practical working out of it. That is what is  
30 happening now to a certain extent, shall we say since



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1 the spring crisis developed. The top people in the  
2 financial field, I am led to believe, are being  
3 asked to come down to Ottawa to discuss these problems.  
4 The Bank of Canada and financial department officials  
5 at different levels, and perhaps even those in  
6 Montreal or Toronto or where they have branches of  
7 the Bank of Canada, are also discussing these practical  
8 problems at their levels, so the formalizing of this  
9 thing, it would seem to me, would be at the top  
10 level, perhaps as far as the publicity which is going  
11 to come out. From the top level it works down to  
12 their deputy level. Really the point we are making  
13 is in the commercial area. We feel this should be  
14 formalized, and it should be a recognized develop-  
15 ment procedure for government liaison with business  
16 and particularly in this element we are talking  
17 about, the financial end of business. It is not  
18 formalized now.

19 COMMISSIONER LEMAN: Sometimes there can  
20 arise a little embarrassment when you have a formal  
21 arrangement like this and the advice that is given  
22 is not followed.

23 MR. STRATHY: Yes.

24 COMMISSIONER LEMAN: Then you go on with  
25 recommendations 5 and 6 which again have something  
26 to do with your feeling about the relations between  
27 the Bank of Canada and the Minister of Finance and  
28 the market. One of the problems that we must keep  
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COMMISSIONER LAMONT: (Interjecting) Yes, sir.

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1 mind. Would you look at this a little bit in the  
2 reverse? Would the industry be willing to train  
3 Bank of Canada personnel if the Bank sent them out  
4 to spend some time in the shops, so-called?

5 MR. STRATHY: Yes, I am quite sure they  
6 would.

7 COMMISSIONER LEMAN: Perhaps that might  
8 be the easier way of accomplishing what you have in  
9 mind, would it not?

10 MR. STRATHY: Yes. I think there is an  
11 area of difficulty here, and perhaps one of the areas  
12 you are pointing out is important. This type of man  
13 says to himself: "I am being selfish but I can get  
14 more from private enterprise than I can get from  
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16 While we did not discuss this reverse  
17 suggestion of yours I am sure the Chamber would  
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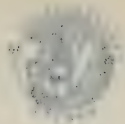
20 COMMISSIONER LEMAN: We have been told that  
21 there has not been a tremendous rush of applications  
22 to the Bank of Canada and the Minister of Finance  
23 from experienced people in the industry.

24 MR. STRATHY: That is right.

25 COMMISSIONER LEMAN: There has not been a  
26 big rush of applications for jobs in those departments.

27 MR. STRATHY: Well, I would think the layman  
28 might well feel that a man brought up in Ottawa in  
29 the Bank of Canada finance department during all  
30 his business career might tend to be a bit ivory





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1 tower. That might be an unfair allegation, but  
2 certainly you can undo some of the ivory tower part  
3 of it by requesting financial business-trained  
4 men, as you suggest, if they cannot get them. I was  
5 thinking, if it is pertinent, of wartime. That was  
6 a type of emergency and the government had no trouble  
7 in drafting businessmen to come down because of the  
8 nature of that emergency. It was tremendously  
9 dramatic.

10 COMMISSIONER LEMAN: The famous dollar -  
11 a year man?

12 MR. STRATHY: Right. It seems to me that  
13 possibly business has to accept this responsibility  
14 and in different degrees of crises they might be  
15 expected to do the same kind of thing -- in a  
16 different degree with much fewer people involved.  
17 Maybe that is being a little bit idealistic, but  
18 certainly we have gone through a crisis and the  
19 best brains are needed in times of crises. Now,  
20 the best brains may happen to be both in and out of  
21 Ottawa.

22 COMMISSIONER LEMAN: Getting them together  
23 is the problem?

24 MR. STRATHY: Getting them together is  
25 the problem. I have not solved how you do it though  
26 because there is a problem of money; pay.

27 COMMISSIONER LEMAN: Yes, because obviously  
28 these people you are referring to certainly are not  
29 junior people. They would have to be the top men?

30 MR. STRATHY: No, they would have to be



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1 drafted.

2 COMMISSIONER LEMAN: On page 8 you make  
3 a statement under section 3(a) when you comment on  
4 monetary policy and at the end of the first paragraph  
5 you state your belief that monetary policy will have  
6 a powerful and pervasive effect which is absent from  
7 other stabilization techniques. Well, now, can you  
8 adduce a little evidence about the effectiveness of  
9 monetary policy, the classic type of monetary policy  
10 instrument?

11 MR. EDMISON: Mr. Commissioner, you were  
12 asking us whether we think that monetary policy is  
13 effective in all circumstances?

14 COMMISSIONER LEMAN: Well, you sound a note  
15 of great optimism here about the effectiveness of  
16 monetary policy. One of the strange things that  
17 has happened to this Commission is that a lot of  
18 people primarily concerned with monetary policy have  
19 kept telling us that the most effective thing from  
20 the counter-cyclical point of view is fiscal policy,  
21 and most of the people concerned with the fiscal end  
22 have told us that we will get it from the monetary  
23 policy end.

24 MR. EDMISON: Well, you have quoted from  
25 the first paragraph. The second paragraph qualifies  
26 it to some extent in the suggestion that there is  
27 sometimes a tendency to expect too much from monetary  
28 policy. Certainly monetary policy has a good deal in  
29 its favour. If it could be applied promptly and  
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1 persisted in. Let us say in an expansionist period,  
2 or in a period of over-full use of resources, it  
3 could cut a good deal of the final demand out of  
4 the system. Perhaps if you took the present context  
5 as an illustration it will help. At the present time,  
6 and I am speaking for myself here -- I do not know  
7 whether my colleagues would agree with me, but at  
8 the present time it seems to me we would virtually  
9 have to depend to an important extent on monetary  
10 policy, looking at it over a period of years. In  
11 fiscal policy we already have a very large deficit.  
12 If you try to increase that deficit very substantially  
13 from here, as recent experience shows, you tend to  
14 get some negative results from that, both in the  
15 balance of payments area and perhaps generally, and  
16 in the capital markets to some extent.

17 In the case of monetary policy we  
18 are at the moment at least in a non-inflationary  
19 environment. We have a lot of our resources, both  
20 plant and human, unutilized. We have a classic  
21 situation where monetary policy can be applied. Based  
22 on most recent evidence that appears to be taking  
23 place within the framework of the problems on our  
24 balance of payments that we went through earlier in  
25 the year. Certainly in the present context you  
26 might say even by default we are obliged to use  
27 monetary policy in an expansionist way if we want  
28 to take up some of the slack in the economy.

29 One could expand the argument a little  
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1 certain useful steps are being taken, some of the  
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3 other people and not made by us at all.

4 COMMISSIONER LEMAN: Well, some of the  
5 students of monetary policy as an instrument who are  
6 very close to the subject -- people working at it  
7 all day long -- tell us that it is still pretty hard  
8 to measure exactly what a certain dose of monetary  
9 action will accomplish in the economy. That is why  
10 I was wondering what was the basis of your great  
11 optimism in its effectiveness.

12 MR. EDMISON: I would not say that this  
13 particular statement is terribly optimistic. It is  
14 true the word "powerful" is used.

15 COMMISSIONER LEMAN: And "pervasive".  
16 MR. EDMISON: But  
17 the word "powerful" is the word I guess you are  
18 seizing upon here rather than what follows in the  
19 next paragraph. Actually, let us say, the multiplier  
20 effects of monetary policy are very hard to discern.  
21 You can expand the money supply and if people are  
22 willing to borrow money and take risks -- they are  
23 not always willing to do so, but if they are willing  
24 to do so, then obviously monetary policy can be  
25 effective in an expansionist situation. It is possible  
26 that a set of circumstances could exist where you  
27 could increase the money supply and nothing happens.

28 COMMISSIONER LEMAN: Well some of you, or  
29 a lot of you represent large industries in Canada,  
30 or large companies. Among the group of you, would  
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COMMISSIONER LEWIS: Well, some of you, or

a lot of you represent large industries in Canada,

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you think that in general the companies you represent





1 were affected in their capital investment plans by  
2 a change in the rate of interest of say 2 per cent?

3 MR. STRATHY: Oh, yes.

4 COMMISSIONER LEMAN: On the up side?

5 MR. STRATHY: In my particular business  
6 I saw it actually happen. In other words, the  
7 financing plans were discarded. The cost of money  
8 was too much and it changed over-night. Would you  
9 not say that was monetary policy coming down pretty  
10 hard, pretty fast and vigorously?

11 COMMISSIONER LEMAN: Yes, that would be  
12 a measure of effectiveness.

13 MR. STRATHY: And the multiplier applied  
14 to that, which is perhaps intangible, I think would  
15 be there and would have a rippling effect.

16 COMMISSIONER LEMAN: Should I then gather  
17 from the same sentence, and perhaps I put too much  
18 significance in the earlier sense in which I used it --  
19 should I then gather from it that you feel that up  
20 to now our monetary action in Canada has been a little  
21 too timid and not decisive enough?

22 MR. EDMISON: What period of time have  
23 you in mind?

24 COMMISSIONER LEMAN: Well, let us take  
25 the post-war.

26 MR. EDMISON: I would say in the last five  
27 years it has been. Since 1956 it certainly has been,  
28 in my opinion. I do not know whether my colleagues  
29 agree with me, but I think if you are talking about  
30 the very recent term, monetary policy very recently is



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1 being paced probably as fast under all circumstances  
2 as it could be. Of course, we have the external  
3 influences as well. You have got our monetary  
4 authorities thinking in terms of what the Federal  
5 Reserve is doing. Happily the Federal Reserve for  
6 the moment is in an expansionist move and therefore  
7 it makes it easier for us to implement an expansionist  
8 monetary policy which might have been precluded under  
9 certain circumstances.

10 COMMISSIONER LEMAN: When we consider the  
11 amount of determination with which it should be  
12 exercised, a little later on on page 9 you express  
13 what I interpret to mean a recommendation that it  
14 be used with determination, because you say it may  
15 be recognized generally that tight money is intended  
16 to hurt, and then you go on to say that great care  
17 should be taken to ensure that it does not cause  
18 unjustifiable hardships in particular sectors. There  
19 you are obviously referring to the unequal incidence  
20 of certain actions when they are taken. What are the  
21 sectors where unjustifiable hardships arise mainly?

22 MR. EDMISON: Well, I think it is generally  
23 accepted that monetary policy tends to be a little  
24 blunt. Some people would be a little stronger than  
25 that in language. In a tight or restricted money  
26 period it really means you are allocating resources  
27 and there is a tendency for parts of the economy --  
28 very often it has been said that small business or  
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1 hardship under such conditions than the centres that  
2 are closer to the centres of banking and so on. Of  
3 course, that is perhaps normal if you would call  
4 anything normal in a country as spread out as we are  
5 and operating, let us say, a fairly tight financial  
6 structure. I think it is generally accepted that  
7 the words here are "great care". It would certainly  
8 be, from what I have heard here, that our chartered  
9 banks have been very careful, particularly recently,  
10 in trying to be very fair in the allocation of loans  
11 when loanable amounts were limited, as between the  
12 big borrower and little borrower; that is where  
13 someone lives in a large metropolitan centre as  
14 compared to a business out in a rural area. They  
15 do take great care in this regard. I think we all  
16 admit that there is not any system that cannot be  
17 improved. This is an area in which it presumably  
18 can be improved. Of course, we are talking here not  
19 in the present context to any incident at all. If  
20 we had been in a tight money period for reasons of  
21 our balance of payments situation we would normally  
22 be moving out of it.

23 COMMISSIONER LEMAN: Well, are we then  
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1 MR. EDMISON: The fairness of the incidence  
2 of it, which takes great skill and care and I think  
3 that our banking authorities, from what I hear, are  
4 making every effort to see that that is the case,  
5 and one of your fellow Commissioners would probably  
6 confirm that.

7 COMMISSIONER LEMAN: It might be ideal  
8 that when you are trying to reduce activity, you reduce  
9 everybody's activity by one per cent or 2 per cent,  
10 but it can't work that way, can it?

11 MR. EDMISON: No.

12 COMMISSIONER LEMAN: The way to arrive  
13 at your 2 per cent -- if 2 per cent is what you want --  
14 is by knocking out some things. I don't think you  
15 can obviate that.

16 MR. CREAN: There is getting to be a  
17 bit of an opinion that in times like this it is a  
18 good idea to knock out sections that are not as  
19 economic as others.

20 COMMISSIONER LEMAN: I was wondering if  
21 really I should infer from this that you would be  
22 in favour of selective control?

23 MR. EDMISON: I don't think so. I don't  
24 think we favour that kind of interference with the  
25 free market system.

26 COMMISSIONER LEMAN: There is a certain  
27 amount of selectivity involved in this which has  
28 to be used to ensure that it doesn't cause any hardship?

29 MR. EDMISON: Yes, but the administration  
30 is done by the convention of institutions in the field



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1 and provided that they are doing it with great care,  
2 as it is expressed here; that is about all you can  
3 hope for in a given policy area.

4 COMMISSIONER BROWN: I am not clear on how  
5 this great care will be taken by the monetary authorities?

6 MR. EDMISON: I think the assumption in this  
7 particular sentence that the Commissioner referred to  
8 was that we are talking about a set of conditions  
9 where you, in fact, have a tight money policy and  
10 where resources in a country are strained, and it  
11 is thought desirable that a man be contained by monetary  
12 restrictions through the banking system, and it is  
13 that set of conditions that we have dealt with here  
14 and therefore it is within this framework of a clear  
15 cut monetary policy under these conditions that the  
16 implementation of that policy, which will obviously  
17 create some hardships and a lot of handicaps, obviously  
18 cannot be financed under these circumstances and by  
19 those means envisaged.

20 COMMISSIONER BROWN: It is the intermediary  
21 you are asking to take great care, not the monetary  
22 authorities?

23 MR. EDMISON: It is just the implementation  
24 of the policy; the administration of your monetary  
25 authorities.

26 MR. KEEPING: I think we have looked to  
27 the intermediaries to exercise care.

28 MR. EDMISON: We are thinking of the  
29 chartered banks.

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1 monetary authorities?

2 MR. KEEPING: No, no.

3 COMMISSIONER BROWN: Could I ask one more  
4 question? You mentioned the Federal  
5 Reserve System and I would like to get your ideas  
6 as to what extent Canada can carry out and maintain  
7 an independent monetary policy, particularly with a  
8 fixed exchange rate?

9 MR. CREAN: I would think that surely  
10 monetary policy and fixed exchange rates are also all  
11 tied up with the flow of capital coming into the  
12 country and the level of your tariffs and quotas.  
13 It is all there in the package, surely, isn't it?

14 You can probably maintain a relatively  
15 independent monetary policy if you want to do certain  
16 other things which would tend to put your monetary  
17 policy into operating in a relatively close way.  
18 Surely all these items are inter-related.

19 COMMISSIONER BROWN: But Canada has a fairly  
20 open economy; I think we are all agreed on that?

21 MR. CREAN: At the moment, yes.

22 MR. EDMISON: I think the Commissioner's  
23 point was that if you have a fixed exchange rate which  
24 you must defend, and you are north of a country where  
25 you have a monetary policy operative that might be  
26 going possibly in the same direction but at a different  
27 pace, that you place some restriction on how far one  
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1     suppose under a flexible rate theoretically you don't  
2     need any reserves, but I suppose in practice you do.  
3     Theoretically you don't, but under a fixed rate you  
4     have to have reserves to defend your rate and therefore  
5     you have to watch perhaps more closely than otherwise  
6     the activities of the Federal Reserve System. I think  
7     this is an overall background factor in most cases  
8     of the massive amounts of capital that can and do  
9     move across that border.

10                COMMISSIONER LEMAN: If I might go on to  
11     your recommendations 8 and 9 there. I gather that  
12     most of what you had in mind in this area when you  
13     speak of more public information, more public education  
14     on these economic and financial considerations, that  
15     is basically more statistics, more information, that  
16     you feel should be promptly gotten out to the public  
17     so that they can interpret the figures themselves, or  
18     is it the interpretation of the monetary authorities  
19     that you want them to have, in other words, an open  
20     mouth policy; you want the monetary authority to  
21     interpret the figures for the public and say what  
22     it makes of the situation?

23                MR. CREAN: This is a problem which the  
24     Chamber has in its own field. We put certain state-  
25     ments out, we put certain briefs out -- I hope this  
26     is not going to be one of them -- but I, in my travels  
27     across the country in years gone by have often been  
28     tackled by smaller businessmen who will say, "Why do  
29     you want to put all that stuff out; nobody can under-  
30     stand it anyway." Now, this is said more jokingly



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1 than anything else, but it is the same thing here,  
2 because I think your point of interpretation is the  
3 key, because I don't think more statistics would be  
4 the answer because you are talking to the grass-roots,  
5 a good many of the grass-roots people haven't time  
6 to spend, nor would it be of particular benefit to  
7 them if they did spend a lot of time going over reams  
8 of statistics and therefore the problem so often comes  
9 down to two issues; monetary policy, what does he  
10 think monetary policy means to him? He will relate  
11 it to whether it will give him an extra few thousand  
12 dollars, or relate it to something to do with -- maybe  
13 quite incorrectly -- to do with this crisis we have  
14 had in the last two or three months, but he is always  
15 going to try to bring it back to his own personal  
16 little affairs and maybe by doing more of a job  
17 of interpretation or by putting the financial press  
18 maybe in a more readily assembled form and they can  
19 disseminate that information, that might be helpful.

20 COMMISSIONER LEMAN: But these are areas  
21 where there is always room for a lot of arguments,  
22 are they not?

23 MR. CREAN: Yes.

24 COMMISSIONER LEMAN: Would you concede  
25 that the monetary authority more or less is in a  
26 position of trying to make people do what at that  
27 moment they do not want to do?

28 MR. CREAN: I don't think you would be  
29 realistic and deny that!

30 COMMISSIONER LEMAN: I am wondering if





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1 partly what is missing in Canada is a more informed  
2 financial press?

3 MR. STRATHY: Yes.

4 MR. CREAN: I think so.

5 MR. STRATHY: If I can say a word, some  
6 years ago I was involved in bringing over a number of  
7 members of the British Financial Press and so the  
8 format was to get the local financial press to get  
9 together for an open discussion with the British  
10 Financial Press, and I am not taking sides with the  
11 British Financial Press, but it was a most interesting  
12 discussion and the British Financial Press said that  
13 they considered their role as interpretative and  
14 analytical and constructive in what they were doing,  
15 whereas they said in their view the Canadian Financial  
16 Press were just reporters, so that I think perhaps  
17 there is a certain amount of truth in that in Canada.  
18 It is just a reporting job that is done instead of  
19 an interpreting job. So that the Bank of Canada  
20 issues weekly and monthly financial statistics that  
21 are extremely valuable, they are magnificent in their  
22 spread of information and they go to the masses, but  
23 if we go back to these masses that were represented,  
24 they don't see them and they don't understand them,  
25 but the financial press is an intermediary and it  
26 goes a long way towards educating the people who are  
27 affected by monetary policy.

28 In our discussions I feel that is what we  
29 felt; in other words, public relations had to be  
30 improved, and I don't say that that means the Bank of



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2 there should be someone in between the public and  
3 the Bank of Canada, which is perhaps the financial  
4 press, and we think a lot could be done. That is  
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6 COMMISSIONER LEMAN: Even in financial  
7 circles, many people who are fairly adept at the  
8 study of statistics and trying to analyse the state  
9 of the economy, very often there arises a lot of  
10 discussion as to what would be the best direction to  
11 take as of a certain moment, but it is not too cut and  
12 dried. I believe that the monetary authorities at  
13 times would feel a little bit embarrassed by the  
14 burden of coming up and saying exactly where they  
15 think we are headed for the next few months.

16 MR. STRATHY: It wouldn't be appropriate  
17 for them at the time.

18 MR. EDMISON: I think that the point in  
19 recommendation 7 which is discussed here is national  
20 and interpretative. Recommendation 8, which is  
21 about the bank rate, I think you have coupled that  
22 in your original remarks. Recommendation 8, I think,  
23 was considered more as something beamed at the  
24 financial community, and that the bank rate is a  
25 signalling device and that it would be indicating  
26 what the trend is, what the policy direction is,  
27 at a given time in clear and unmistakable terms.  
28 Recommendation 7 is something that we have put in  
29 an ad hoc policy; something which has developed over  
30 a period of time, an educational interpretative policy



Canada has to develop a lot of public relations, but there should be someone in between the public and the Bank of Canada, which is perhaps the financial arm, and we think a lot could be done. That is what we are looking for.

QUESTIONS: (a) How is the Bank of Canada?

ANSWER: Many people who are fairly adept at the study of statistics and trying to analyse the state of the economy, very often there arises a lot of discussion as to what would be the best direction to take as of a certain moment, but it is not too out and dried. I believe that the monetary authorities at times would feel a little bit embarrassed by the burden of coming up and saying exactly where they think we are headed for the next few months.

MR. STRATHY: It wouldn't be appropriate for them at the time.

MR. EDMISON: I think that the point in recommendation 7 which is discussed here is national and interpretative. Recommendation 8, which is about the bank rate, I think you have coupled that in your original remarks. Recommendation 8, I think, was considered more as something deemed at the financial community, and that the bank rate is a signalling device and that it would be indicating what the trend is, what the policy direction is, at a given time in clear and unmistakable terms. Recommendation 7 is something that we have put in an ad hoc policy; something which has developed over a period of time, an educational interpretative policy



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2 like the Canadian Chamber of Commerce as well as others,  
3 as well as financial people.

4 THE CHAIRMAN: We will adjourn now for  
5 five minutes.

6 --- Recess.  
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1 THE CHAIRMAN: We shall resume now.

2 COMMISSIONER LEMAN: I have just one more  
3 question in this area of your submission, gentlemen,  
4 and that is the one where you refer to the composition  
5 of a Board of the Bank of Canada. There again, I  
6 suppose, we can visualize some difficulties about  
7 endeavouring to get quite the kind of composition  
8 you seem to be proposing here. Could you get down  
9 to a little bit more definite example of what you  
10 mean? For instance, do you think you could have  
11 active commercial bankers on the Board?

12 MR. STRATHY: That is an awkward area  
13 with Mr. Commissioner Gibson here.

14 COMMISSIONER GIBSON: We want your opinion.

15 MR. STRATHY: If you take the Bank of  
16 England, in my knowledge of the setup of the governors  
17 there, they are active, commercial bankers. They  
18 may be termed merchant bankers and they may not be  
19 exactly the same as a merchant banker in Canada,  
20 but they are free enterprise individuals in their  
21 own businesses in the financial community. I am  
22 led to believe that they fulfill the function  
23 as governors of the Bank of England in a very satisfactory  
24 manner. That is the angle we are pointing up here  
25 in this brief, that that type of man, if there is a  
26 counter-part to him, should be a director of the  
27 Bank of Canada. I would suggest our feeling is that  
28 the present directors have been selected on a more  
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1 the result that probably the best technical people  
2 for that role are not provided.

3 COMMISSIONER LEMAN: If you could  
4 conciliate geography with competence you would still  
5 try to do it in that way?

6 MR. STRATHY: Yes, certainly.

7 MR. CREAN: That is the thread which runs  
8 through our whole system, any system we have in  
9 Canada, the difference of England being a relatively  
10 small area and Canada being not only a very large  
11 area but a federal system or confederation.

12 COMMISSIONER LEMAN: How about an active  
13 partner of a bond dealers' firm?

14 MR. CREAN: Well, if he was the best man,  
15 I would say yes. Someone might argue he is privy  
16 to expert knowledge, which might set up some type  
17 of problem, but if he is a top-calibre man and is  
18 the best man then he should be there. He knows how  
19 to act in his dual capacity, or he should.

20 THE CHAIRMAN: Who is going to decide  
21 whether or not he is the best man?

22 MR. EDMISON: That is the problem with all  
23 appointments, is it not?

24 THE CHAIRMAN: That is right; unless you  
25 had a set of examinations they had to pass.

26 COMMISSIONER LEMAN: At least you feel the  
27 government should try, and see what happens?

28 MR. STRATHY: Yes.

29 COMMISSIONER LEMAN: Those are all  
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1 MR. EDMISON: The Commissioner spoke of  
2 bankers. You have right now a former chairman and  
3 president of a chartered bank and, as a matter of  
4 fact, a former president of this organization, Mr.  
5 Ashforth, who is a director and is obviously a very  
6 experienced person who would fit into this.

7 COMMISSIONER BROWN: Mr. Chairman, I should  
8 like to move from monetary policy to fiscal policy.  
9 On page 10 of the brief you say that you would favour  
10 tax adjustments rather than changes in government  
11 spending, particularly government spending which  
12 cannot be reversed quickly and which does not add  
13 to useful social capital. Just why do you make this  
14 choice, and what sort of tax adjustments are you  
15 thinking of?

16 MR. EDMISON: Mr. Commissioner, I think  
17 the feeling of the Canadian Chamber of Commerce  
18 is that the more desirable way, perhaps not as a  
19 fixed rule but the more desirable fiscal approach  
20 is on the revenue side, as we pointed out, because  
21 it is more flexible. If you have a fiscal policy  
22 that you wish to use to reactivate an economy, and  
23 later on you feel that such policies are no longer  
24 required, tax changes can be reversed quickly,  
25 whereas certain other kinds of programmes, the  
26 expenditure type programmes, generally speaking,  
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30 Even the fixed capital outlays are rather





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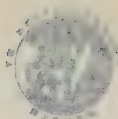


1 difficult to reverse, for they take a period of  
2 time. So, generally speaking, the feeling is that  
3 if you desire to use that fiscal policy as an anti-  
4 cyclical measure with this kind of a tax-cut method  
5 of corporate tax and individual income tax -- and  
6 most previous briefs of the Chamber have been in  
7 this direction -- it is felt that as we are a develop-  
8 ing country these rates are too high and at the  
9 earliest possible opportunity the rate structure  
10 should come down. Probably the present time is an  
11 inappropriate one to reduce them, but the time should  
12 come when it is possible to use fiscal measures in  
13 that way.

14 COMMISSIONER BROWN: Would you confine  
15 it to corporation and personal income tax fields?

16 MR. EDMISON: Our feeling is that from the  
17 point of view of incentives, those are the more  
18 desirable areas to work on, apart from anomalies  
19 in the tax system which could be cleared up. There  
20 are always those which could be cleared up from time  
21 to time, but in this context we feel that the  
22 individual income tax and the corporate tax structure  
23 are the areas where the operating fiscal policy  
24 on the revenue side could be most effective and  
25 expedient.

26 MR. KEEPING: Particularly in the corporate  
27 tax field. In my opinion the corporate tax almost  
28 forms the cost of goods sold, and a reduction of the  
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1 both in our home market on imported products and  
2 in our foreign markets.

3 COMMISSIONER BROWN: Could we take this  
4 as an understanding, that the price of products would  
5 be reduced if corporate taxes were reduced?

6 MR. KEEPING: I think it is logical to  
7 assume that that would be the case. Businessmen are  
8 honestly trying to expand their trade and certainly  
9 a great factor which would help them to expand their  
10 trade at the moment would be to reduce their prices  
11 so that their products could be more competitive,  
12 particularly in foreign markets.

13 COMMISSIONER BROWN: You heard Dr. Eaton  
14 this morning. He was of the opinion similar to that  
15 which you have just expressed, that corporate tax  
16 is passed on in the cost of goods. I would gather  
17 you would agree with that thesis as a general  
18 statement?

19 MR. KEEPING: I do.

20 COMMISSIONER GIBSON: As a general statement,  
21 but are there exceptions to the degree that corporate  
22 income tax is passed on?

23 MR. KEEPING: No. I think it is difficult  
24 to measure the degree to which it is passed on. I  
25 believe it has become so built into the cost it is  
26 passed on to all intents and purposes.

27 MR. EDMISON: Probably there are areas  
28 where no cost can be passed on.

29 COMMISSIONER GIBSON: That is what I was  
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1 MR. CREAN: I think the degree of passing  
2 it on is very much dependent on how competitive the  
3 industry is. In many industries there is a good  
4 percentage of the income tax passed on. They would  
5 be far and away the majority of the industries in  
6 this country.

7 COMMISSIONER BROWN: I gather you see no  
8 political problem in raising these taxes again when  
9 conditions are good in order to pay off the debt  
10 incurred when we ran deficits?

11 MR. CREAN: I never noticed any particular  
12 outcry against raising corporate taxes; I mean,  
13 from a political angle most people seem to say it is  
14 a good thing.

15 MR. KEEPING: I am sure there would be  
16 squawks from businesses, but I think businessmen would  
17 realize that in the long term we have to balance our  
18 budget and operate in a business-like way as a  
19 nation.

20 COMMISSIONER BROWN: You speak about fiscal  
21 incentives and fiscal restraints, and you give some  
22 examples of fiscal incentives. You mention the  
23 Swedish system of tax-free investment reserve. Those  
24 carry with them government permission to use them  
25 in specific areas when it is thought that the  
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28 MR. CREAN: Surely no more than any other  
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30 COMMISSIONER BROWN: Except they can be



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2 that is, if you are going to retain tax advantages.

3 MR. CREAN: At least you have some hope  
4 that some day you can use them.

5 COMMISSIONER BROWN: But you do not feel  
6 this is repugnant to your concept of free enterprise?

7 MR. CREAN: Personally, no.

8 MR. KEEPING: No, I feel, Mr. Commissioner,  
9 that we have to raise a certain amount of revenue  
10 in the government to cover expenditures, the necessary  
11 expenditures anyway, and it is incumbent upon us  
12 and on our government to raise that money in as equitable  
13 a way as possible so that it will, among other things,  
14 to the greatest extent promote the economy and foster  
15 economic credit. This is, as you are well aware,  
16 a big problem which is up before another Royal  
17 Commission.

18 COMMISSIONER BROWN: Yes, this is a problem  
19 before another Royal Commission.

20 MR. EDMISON: We mention further on in our  
21 brief that this would be an incentive for corporate  
22 savings, at least more incentive than otherwise, if  
23 such reserves could be set aside for the future without  
24 a tax penalty.

25 COMMISSIONER BROWN: I should like to  
26 return for a moment to a point discussed at the  
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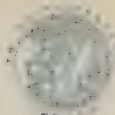
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6 finances. Then there is a gap which has not been  
7 filled.

8 Presumably the Industrial Development  
9 Bank is one of the instruments which is set up to  
10 fill such a gap, and these new private enterprise  
11 companies, as we mentioned earlier, have also been  
12 set up to provide the finances to fill these gaps.

13 COMMISSIONER BROWN: In other words, if somebody  
14 is deserving of financing but is unable to find it  
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16 MR. STRATHY: May we refer to my particular  
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19 amount of capital for a small company that is credit-  
20 worthy, the cost is too high.

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22 The amount of dollars related to the amount of funds  
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25 the medium of the business which I represent, it  
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1 The companies have to give away controls.

2 THE CHAIRMAN: There are thousands of  
3 small businesses carrying on today and presumably  
4 making a profit. They must all have raised money  
5 somehow at one time or another.

6 MR. STRATHY: Probably privately through  
7 their friends or families, family funds. I should  
8 think there are thousands of them, of course.

9 COMMISSIONER BROWN: What I am trying to  
10 get at is whether, with respect to filling some gaps  
11 in the capital market, you are concerned with the  
12 cost of raising the capital or the risk involved?

13 MR. STRATHY: First of all, if there is  
14 all that risk involved then perhaps the credit  
15 worthiness is not there and it should not be publicly  
16 financed except as a speculation. But I think in  
17 our discussion we are referring more to costs.

18 COMMISSIONER BROWN: That is what I wanted  
19 to know.

20 MR. STRATHY: The Industrial Development  
21 Bank presumably provides those finances at a lower  
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24 COMMISSIONER BROWN: Perhaps we could have  
25 a little discussion on the Industrial Development  
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1 MR. KEEPING: I would say myself, Mr.  
2 Commissioner, that the Industrial Development Bank  
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5 a question as to whether at the present time, perhaps  
6 since the expansion and the amendments to the  
7 Industrial Development Act some eighteen months ago,  
8 it is not now getting into a field where it is,  
9 supplying funds to organizations which could raise  
10 those funds in the private sector. They would pay  
11 more for them but they could perhaps afford to pay  
12 more for them. I feel strongly there is a gap which  
13 I think the Industrial Development Bank has filled  
14 in the past and has rendered a great service, but I  
15 do think there is a grave danger myself that with  
16 the degree of expansion going on and with the comparatively  
17 cheap money it is able to supply, without taking into  
18 account the risks involved, it is going to enter into  
19 and is perhaps to some extent now engaging in  
20 activities which could be catered to by the private  
21 sector, which in my opinion, is undesirable. I think  
22 what we want to emphasize in our submission here  
23 is that we feel there is a place for an institution  
24 such as the Industrial Development Bank, but we  
25 do not feel its place is in that sector which can  
26 be filled by private enterprise.

27 COMMISSIONER BROWN: What is the cost  
28 differential that you feel has to exist in a decision  
29 being made by the I.D.B. as to whether this is properly  
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it is not now getting into a field where it is applying funds to organizations which could raise those funds in the private sector. They would pay more for them but they could perhaps afford to pay more for them. I feel strongly there is a gap which I think the Industrial Development Bank has filled in the past and has rendered a great service, but I do think there is a grave danger myself that with

the degree of expansion going on and with the comparatively cheap money it is able to supply, without taking into account the risks involved, it is going to enter into and is perhaps to some extent now engaging in activities which could be catered to by the private sector, which in my opinion, is undesirable. I think what we want to emphasize in our examination here is that we feel there is a place for an institution such as the Industrial Development Bank, but we do not feel the place is in that sector which can be filled by private enterprise.

COMMISSIONER BROWN: What is the cost differential that you feel has to exist in a situation being made by the I.D.B. as to whether this is properly





1 their field or whether it should be financed elsewhere  
2 at a higher cost?

3 MR. KEEPING: I am not too familiar with  
4 this but I believe the I.D.B., under its Act, is  
5 really incorporated only to negotiate loans in cases  
6 where financing is not available from other quarters,  
7 and I believe they do take some steps, to what  
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1 COMMISSIONER BROWN: Have you any  
2 suggestions as to improvements that you would like  
3 made?

4 MR. KEEPING: Not specifically. We make  
5 the recommendation here that a review be made in  
6 an endeavour to ascertain to what extent government  
7 financial institutions are impinging upon the private  
8 sector of the economy, and where it is thought  
9 desirable that such a review be made. We think if it  
10 should appear that government financial institutions  
11 are competing in the private sector then the government  
12 should vacate those areas.

13 COMMISSIONER BROWN: Some of these have  
14 been developed by government institutions showing  
15 the way, so to speak, and then private interests  
16 have come along. Do you say that this is a good  
17 area for the government to investigate?

18 MR. KEEPING: I could not agree more.

19 COMMISSIONER BROWN: And would you have  
20 the government institutions back away as private  
21 enterprise comes into the picture? That is what I am  
22 trying to get at.

23 MR. KEEPING: Yes. I think certainly in  
24 certain new products and new developments I think  
25 there is a field for the I.D.B. It is, I think,  
26 important so far as our economy is concerned, because  
27 I think our success in world markets will depend  
28 upon the development by us of new products.

29 COMMISSIONER BROWN: If the government agencies  
30 are going to do this should they step into fields which





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4 Would you not also accept the thesis that in taking  
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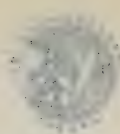
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9 some degree of subsidy in the initial stages. As  
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11 of subsidy of this nature on a permanent and continuing  
12 basis, but I think you cannot argue otherwise.

13 COMMISSIONER BROWN: You can argue against  
14 the subsidy, but I want to know whether this was  
15 solely an argument against the subsidy?

16 MR. KEEPING: If the private sector cannot  
17 supply the funds at a reasonable cost then I think  
18 it is desirable in some instances that the government  
19 should step in, and to that degree I think you could  
20 say it is subsidized.

21 COMMISSIONER LEMAN: Before you leave that  
22 area I might mention that I am wondering whether,  
23 without getting into actual quantitative measures,  
24 you can give us the broad features of a situation  
25 in which it would be appropriate to resort to  
26 deficits in order to help the economy along. I  
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1 the situation in your economy and the amount of  
2 unused resources you have, and particularly the amount  
3 of unemployment that would cramp such policies  
4 in the first instance.

5 COMMISSIONER LEMAN: We have got both  
6 of those now.

7 MR. EDMISON: That is right, but we  
8 also have a rather large deficit now. Some people  
9 would argue that the deficit could be larger. We  
10 have had, of course, somewhat larger deficits than  
11 that that was forecast yesterday for the current  
12 fiscal year. We have had these rather large deficits  
13 in the past, and they have had a stimulating effect  
14 on the economy during that current year. However,  
15 there comes a time when the size of the deficit creates  
16 problems in itself and, therefore, if you engage  
17 in tax reductions at a time like the present you are  
18 going to increase the size of that deficit. It is  
19 quite possible that some kind of tax reductions,  
20 or deferment of taxes such as in the case of more  
21 rapid depreciation write-offs, and allowances for  
22 expenditures on research and development, and that  
23 immediate loss of tax revenue, would be justified  
24 even though there is a fairly large deficit because  
25 of the productive results.

26 However, if you engage in any massive  
27 tax reductions with a deficit such as the present  
28 one you can bring upon yourself another set of  
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1 you talk about co-ordination of policies, and the  
2 emphasis on certain policies, it would appear at  
3 the present time in the policy area that one should  
4 lean a little bit more on the monetary policy than  
5 on the fiscal policy. I say that in the light of  
6 the circumstances we now face.

7 COMMISSIONER LEMAN: It has been suggested  
8 to us at times by many people that neither monetary  
9 policy nor fiscal policy alone would ever do the  
10 job when there is a real job to be done; that you  
11 must use both together in order to get somewhere.  
12 I am just wondering if you can find some typical  
13 circumstance in which the weight of informed opinion  
14 would favour tax reductions for this purpose.

15 MR. EDMISON: As you fully recognize, you  
16 must look at all the circumstances at any given time.  
17 At the present time we are well along in this particular  
18 phase of recovery. 1962 so far has shown something  
19 in the order of a 6 per cent increase in the G.N.P.  
20 over that of last year in real terms. Thus far  
21 in this recovery there has not been anything that  
22 could be described as excessive. I mean you have  
23 not got any excessive capital outlays. You have not  
24 got a great build-up of inventories and using certain  
25 criteria, at least, you have not really any great  
26 excesses in consumer credit. Therefore, at the  
27 present time, and in the face of the facts that we  
28 have had, and have in prospect, a sizable government  
29 deficit, and deficits at certain other levels of  
30 governments in the country, it would appear that the



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1 stage is set for monetary policy to be used as the  
2 main instrument. I do not mean to imply that fiscal  
3 policy cannot be employed, but I think that monetary  
4 policy is the area in which we could move at the  
5 present time because there does not seem to be much  
6 danger in its use.

7 We are in a non-inflationary environment.  
8 We have a tremendous excess capacity in the country,  
9 and we have not any excesses that need to be worked  
10 out by the kind of monetary policies that were  
11 appropriate a few years ago, notably in 1956. This  
12 is an entirely different climate and environment.

13 COMMISSIONER LEMAN: With the hope that  
14 you could knock two or three percentage points off  
15 the unemployment index?

16 MR. EDMISON: That is right.

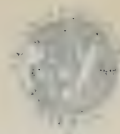
17 MR. STRATHY: May I be excused, Mr. Chairman?  
18 I am afraid I could not obtain space on a later  
19 flight.

20 MR. CASE: I have to make the same excuse,  
21 sir.

22 THE CHAIRMAN: Yes.

23 COMMISSIONER BROWN: On page 12 you refer  
24 to the Annual Reports of government financial insti-  
25 tutions; that they should give more information and  
26 so forth. Has the Chamber an opinion on the financial  
27 statements published by corporations? Do you regard  
28 them as adequate and frequent enough?

29 MR. KEEPING: I do not think, sir, that  
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2 COMMISSIONER BROWN: It has been suggested  
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4 many of the financial statements of corporations in  
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6 might be encouraged.

7 MR. KEEPING: Speaking personally, I think  
8 there has been a tremendous improvement in the  
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10 that in some cases there is still something left to  
11 be desired. I think our Federal Companies Act is  
12 out-dated, but I cannot say the same thing about the  
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14 COMMISSIONER BROWN: I do not think that  
15 we permit apple polishing here, do we, Mr. Chairman?

16 MR. KEEPING: I say that, sir, because  
17 I have had the pleasure of appearing before your  
18 Chairman when he was on the Select Committee which  
19 was considering the revision of the Ontario statute  
20 in 1953, I believe it was.

21 COMMISSIONER BROWN: This follows your  
22 point on page 13 about improvements in the capital  
23 market generally. You deplore the abuses and the  
24 unethical methods in the sale of risky and highly  
25 speculative stocks. This naturally leads to the  
26 question of control over raising capital generally  
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2 not understand your question in the first place. Would  
3 you mind repeating it for me. I am slightly deaf.

4 COMMISSIONER BROWN: You are obviously  
5 unhappy about some of the operations that are indulged  
6 in by people raising new capital in Canada.

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9 recommendations you have to make for improvements  
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11 MR. KEEPING: I do not think we would be  
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15 There has been undoubtedly, over the past years,  
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20 One improvement would be a fuller and more fair  
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23 definitely would not advocate an organization such  
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26 COMMISSIONER BROWN: Why not?

27 MR. KEEPING: Because we believe it to  
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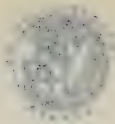
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9 two of our members, unfortunately.

10 COMMISSIONER BROWN: Perhaps I can go on.  
11 You recommend the removal of the 6 per cent ceiling  
12 on bank interest. Do you think that higher rates  
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15 MR. KEEPING: If higher rates were to  
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5 COMMISSIONER BROWN: Do you think that  
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8 MR. KEEPING: Small changes?

9 COMMISSIONER BROWN: Yes.

10 MR. KEEPING: Well, it depends on what  
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6 COMMISSIONER BROWN: So changes in the  
7 interest rates would probably not operate to  
8 ration credit?

9 MR. KEEPING: I do not think so.

10 MR. CREAN: It might have some effect.

11 COMMISSIONER BROWN: Would it have a larger  
12 effect on small business in the 21 per cent tax  
13 bracket as against the larger type in the 50 per cent  
14 tax bracket?

15 MR. CREAN: It is very hard to say in  
16 advance. Surely that would be found out by the  
17 policies of each individual bank.

18 MR. KEEPING: It is obviously costing the  
19 small taxpayer in the lower bracket more of his own  
20 money, but I still doubt whether it would be a major  
21 factor in arriving at his decision.

22 MR. EDMISON: From the standpoint of the  
23 lender, Mr. Commissioner, if you had a more flexible  
24 bank rate interest structure, logically there would  
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1 make for a little more normal lending operations on  
2 the part of the banking system. I think the result  
3 would be indeterminate. I do not think any one of  
4 us could say what it would be. Obviously it would  
5 create more, let us say we hope, employment creating  
6 loans because of these margin situations that would  
7 be developing under the circumstances, but it still  
8 does not rule out the competition that exists in the  
9 banking structure. There is a good deal of that.  
10 This would make the whole rate structure more flexible.

11 MR. CREAN: I am told, Mr. Commissioner,  
12 that the rates which some small businesses pay for  
13 financing makes 6 per cent look like peanuts.

14 COMMISSIONER BROWN: And these people  
15 would probably be able to borrow more cheaply at  
16 chartered banks?

17 MR. EDMISON: Appreciably more cheaply.

18 MR. CREAN: That does seem to be an  
19 anomaly because the small businesses certainly, in my  
20 little experience, do borrow from these financial  
21 institutions at a rate which is not even comparable  
22 to the bank rates.

23 COMMISSIONER BROWN: In connection with  
24 the chartered banks, you have a sentence at the  
25 bottom of page 14, that it is recommended that the  
26 chartered banks' freedom in deciding to whom they  
27 should make loans should not be compromised. What  
28 is behind this statement?

29 MR. CREAN: Well, we just want to leave --  
30 what is behind that is, we do not want directives going



make for a little more normal lending operations on the part of the banking system. I think the result would be indeterminate. I do not think any one of us could say what it would be. Obviously it would create more, let us say we hope, employment creating loans because of these margin situations that would be developing under the circumstances, but it still does not rule out the competition that exists in the banking structure. There is a good deal of that. This would make the whole rate structure more flexible.

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COMMISSIONER BROWN: And these people would probably be able to borrow more cheaply at

MR. CRAWFORD: That does seem to be an

exactly because the small businesses certainly, in my little experience, do borrow from these financial institutions at a rate which is not even comparable to the bank rates.

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the chartered banks, you have a sentence at the bottom of page 14, that it is recommended that the chartered banks' freedom in dealing to whom they should make loans should not be compromised. What

is behind this statement?

MR. CRAWFORD: Well, we just want to leave -- what is behind that is, we do not want directives going





1 to chartered banks telling them what class of loans  
2 they are to make. I believe that is what is behind it,  
3 as I recall.

4 MR. EDMISON: There was not any suggestion  
5 that there be any interference between the banks  
6 in their relationships with their customers.

7 COMMISSIONER BROWN: Well, has this got  
8 some historical connotation?

9 MR. CREAN: I would not say so, no. I  
10 think you have got to read it with the sentence that  
11 follows along on top of page 15.

12 COMMISSIONER BROWN: Well, the last sentence  
13 on top of page 15 almost contradicts the sentence at  
14 the bottom of page 14.

15 MR. CREAN: Well, one of the thoughts  
16 behind the second sentence there is that often an  
17 American subsidiary can draw funds from its parent  
18 company if the parent company sees fit to allow it.  
19 This means funds coming in from outside of Canada  
20 which a small business cannot obtain during a period  
21 of moderate stringency.

22 COMMISSIONER BROWN: You say in one place  
23 that there should be no interference with banks  
24 in their decisions, and in the other place you  
25 recommend that the government introduce measures  
26 that will place small businesses with good credit  
27 on equal footing with larger businesses. In one  
28 place you say you do not want any interference with  
29 banks and you immediately turn around and say --

30 MR. CREAN: Well, aren't you confusing two



to chartered banks telling them what class of loans  
they are to make. I believe that is what is behind it.

THE COMMISSIONER: I am not sure that is what is behind it.

that there be any interference between the banks  
in their relationships with their customers.  
COMMISSIONER BROWN: Well, has this got

some historical connection?

MR. GRAM: I would not say so, no. I  
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This means funds coming in from outside of Canada  
which is what the second sentence is talking about.

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place you say you do not want any interference with  
banks and you immediately turn around and say --  
MR. GRAM: Well, aren't you confusing two



1 principles? I do not think they are quite the same  
2 principle at all.

3 COMMISSIONER BROWN: We will leave that.  
4 How about term loans by the banks?

5 MR. EDMISON: Well, term loans are pre-  
6 sumably an alternate access to the capital market  
7 generally. Under certain circumstances they presumably  
8 have their place. You are thinking perhaps of from  
9 one to five years, or something like that which has  
10 to do with the term. In some instances it is appropriate  
11 to have relatively short term obligations of that kind.  
12 In other cases it is more desirable to have 10, 15  
13 or 20 years, or even longer, obligations in the capital  
14 market. I do not think one would generalize. I would  
15 think term loans should have their place just as  
16 serial debentures have their place in a public offering.  
17 The procedure of banks making term loans to certain  
18 kinds of businesses at certain times is appropriate  
19 as well as the sales to underwriters of serial obligations,  
20 as well as long term obligations to the public.  
21 I think these are all media in the sale of securities,  
22 depending on the nature of the business and the times  
23 at which the offering is made.

24 COMMISSIONER BROWN: Well, what I was  
25 really getting at was whether this sentence at the  
26 bottom of page 14 was included to indicate that there  
27 should not be any directive made to banks.

28 MR. CREAN: No, I do not see why there  
29 should be.

30 COMMISSIONER BROWN: Have you any opinion





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really getting at was whether this sentence at the

bottom of page 14 was included to indicate that there

should not be any directive made to banks.

MR. CREAM: No, I do not see why there

should be.

Have you any opinion



1 about whether banks should be given authority to lend  
2 on mortgages other than on N.H.A. mortgages?

3 MR. KEEPING: No, we have not any opinion  
4 on that. We have not given it any consideration.

5 THE CHAIRMAN: Well, that concludes the  
6 discussion, gentlemen. We appreciate your participation  
7 in it as well as the presentation of your brief. You  
8 have been very helpful to us.

9 MR. KEEPING: Thank you very much, Mr.  
10 Commissioner.

11 THE CHAIRMAN: We are much obliged to you.  
12 We shall now adjourn until 9.15 tomorrow  
13 morning. We shall hear the brief to be presented by  
14 the Canadian Labour Congress.

15  
16 --- Adjournment.  
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# Royal Commission on Banking and Finance

DR. A. K. EATON

THE CANADIAN CHAMBER OF COMMERCE

Hearings  
held at  
OTTAWA

Vol.

46A

Date.

October 23, 1962



Official Reporters  
J. J. Nethercut and R. J. Young  
Toronto, Ont.





Nethercut & Young

Toronto, Ontario

MEMORANDUM TO :

ROYAL COMMISSION ON BANKING AND FINANCE

ANALYTICAL COMMENT ON CANADIAN TAX STRUCTURE

BY: DR. A.K. EATON

October 23, 1962





University of Toronto  
Toronto, Ontario

MEMORANDUM

ROYAL COMMISSION ON CANADIAN TAX STRUCTURE

ANALYTICAL COMMENT ON CANADIAN TAX STRUCTURE

BY: DR. A. F. BAKER

October 1, 1964

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ANALYTICAL COMMENT ON CANADIAN TAX STRUCTURE

Introduction

1. The purpose of this memorandum is to place before the Royal Commission on Banking and Finance some views about the broad structure of taxation in Canada and its influence on economic activity, business, saving and investment. Special attention will be given to the effect of taxes on the capital market. Fiscal policy as an alternative or supplement to monetary policy in controlling the economy will be explored. In addition, certain particular subjects will be dealt with.

2. In an exercise of this sort, it is inevitable that opinion rather than fact will bulk large in material presented. In many directions evidence pro or con views put forward is not available. This leaves the field wide open for him who offers opinions and places the burden on him who receives to pass upon the reasonableness of what is asserted.

General Comment on Tax Systems and Tax Changes

3. Forever in every country it is the fate of tax systems to be held in low esteem by their general public. This, of course, is quite natural. Taxes seem to take something more from people than their money. Along with their money, most people seem to lose much of their ability to talk rationally about their own taxes thereafter. Reason and judgment become more than a trifle distorted and the most extraordinary arguments and propositions are quite earnestly put forward by people who in other directions would be utterly ashamed of the obliqueness, transparency or



ANALYSIS OF THE PROBLEM OF TAXATION IN CANADA

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2 about their taxes. With the weight of taxes as it is  
3 today, perhaps this is not surprising but it can be a  
4 bit disconcerting for him who, from these vehement views,  
5 has to separate the wheat from the chaff.

6 4. Periodically, complaints against tax systems  
7 become epidemic. We are, or have recently been, in the  
8 throes of one in Canada. For many months past, speakers  
9 and editors have been avidly taking in each other's  
10 washing on this subject. No very deep truths seem to have  
11 emerged from these outbursts. Mainly, they have repre-  
12 sented nothing more original or subtle than a chronic  
13 bellyache over the high level of taxes. However, due  
14 to the conjuncture of the current chorus with an  
15 election campaign, we have in the making a Royal  
16 Commission to explore and make recommendations.

17 5. There is something a bit pathetic in the  
18 perennial outbursts of legislators and the public pro-  
19 claiming that what this country needs is a complete  
20 review and overhaul of the tax system. Squirring under  
21 the hair shirt of high taxes, an earnest legislator is  
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23 of going about raising money to pay for government than  
24 the one he and his constituents suffer under. If, how-  
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26 latures of other democratic countries, he could hear  
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1 abroad were complaining about tax systems essentially  
2 the same as the one paining him at home. This is  
3 discouraging.

4 6. We have income taxes on individuals, taxes  
5 on corporations, death duties, sales or purchase taxes -  
6 general or on specific items, or both - extra heavy taxes  
7 on liquor, beer and tobacco, customs duties and property  
8 taxes at the local level. That is our package in Canada  
9 and it is pretty standard for most other western  
10 countries. True, there will be differences in detail  
11 and in the extent to which these various kinds of taxes  
12 are used. Revenue from direct taxes, those on income,  
13 corporate profits and property passing on death will  
14 form a larger percentage of the total in some countries  
15 than in others where more emphasis is placed on in-  
16 direct taxes - taxes on expenditure. But few countries  
17 use any good forms of tax that the rest have not heard  
18 about and adopted.

19 7. There are two good reasons for this striking  
20 uniformity in world tax structures. The first is that  
21 good tax sources are scarce. The second is that troubles  
22 in the use of any particular tax multiply rapidly both  
23 in number and intensity as rates move upward. A  
24 variety of taxes spread thinly is the opimum arrange-  
25 ment. Since the variety is limited, the pattern be-  
26 comes uniform with differences mainly in the intensity  
27 of use of each source.

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4 to be less a matter of fact than of opinion. In-  
5 dignation invariably will be voiced over the deductions  
6 allowed to corporations and self-employed persons but  
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8 is ridiculed the world over. Lack of a clear line in  
9 law between capital gains and ordinary income will  
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13 place. This will be a true statement and may pass as  
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15 no other country will have succeeded in doing much  
16 better. Lack of incentives in tax systems is forever  
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18 weep over the ruthless manner in which revenue officials  
19 harass the long-suffering public.

20 9. Review and overhaul of tax systems are  
21 occasionally necessary, usually not, however, with the  
22 idea of dropping certain tax sources from the structure.  
23 Rather they are necessary to give systematic reconsider-  
24 ation to some of the main features of each kind of tax  
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regularity in other countries. Debates on income tax, no matter in what country, will never fail to produce acrimony over the former problem where income appears to be less a matter of fact than of opinion. Indignation inevitably will be voiced over the definition allowed to corporations and self-employed persons but not to employees. The inadequacy of personal exemptions is ridiculed the world over. Lack of a clear line is law between capital gains and ordinary income will scandalize the uninitiated. Some bright fellow is almost certain to point out that the law does not even contain a definition of what income is in the first place. This will be a true statement and may pass as utterly devastating criticism even though the law of no other country will have succeeded in doing much better. Lack of incentives in tax systems is forever deplored. In all legislatures, strong men are made to weep over the ruthless manner in which revenue officials harass the long-suffering public.

9. Review and overhaul of tax systems are occasionally necessary, usually not, however, with the idea of dropping certain tax sources from the structure. Rather they are necessary to give systematic reconsideration to some of the main features of each kind of tax and the internal relations between them. Law, modified by decades of hurried annual amendments, will frequently need re-statement. Certain provisions which have been found useful in a minor section of one kind of tax may deserve broader application as part of the



10. It would not be surprising if at any particular moment the revenue systems of most countries would need overhauling in this sense of internal review and reorganization. This is the sort of job governments naturally tend to shy away from. Tax laws are very complicated, and in them, whole litters of sleeping dogs are lying around, often in the most unexpected places. Ministers instinctively cringe at the prospect of exposing to a critical Parliamentary Committee the host of problems in tax law to which, in truth, there is no really satisfactory answer. For this reluctance no one should blame them and it is not surprising that the time never seems quite ripe for major tax revisions.

11. Furthermore, for those administering tax law, every change is pure grief. Among four and a half million incomes tax payers, many are not easily moved into new ways of doing things. Tax administrators will invariably agree with the Minister that one should not rush into these things. Also, officials of the Department of Justice at the drop of a hat containing a suggestion for rewriting tax law will, with unusual promptness, deliver an opinion that whereas words and phrases in the existing statute have been construed and interpreted by Courts and whereas a revision of the statute would largely nullify this body of jurisprudence built up over the years which gives certainty to the law, now therefore it would be too bad at this stage to upset the applecart - and up to a point this makes a great deal of sense.





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12. The Canadian tax system less than any other one could name among Western countries needs, general revision and overhauling. In 1948, after thirty years of patchwork adjustments and amendments, and following the disruption of the War, the Income Tax Act was completely pulled apart and systematically put together again. The result was an income tax law that few other countries can match in up-to-dateness. Also during this period the sales and excise tax structure was greatly simplified and standardized. The Report of the Carter Committee on sales tax contains many useful recommendations in this field. The utterly complicated and illogical Dominion Succession Duty Act was then worked on and a major operation was performed in 1958, the result of which is a good, simple statute taxing estates of deceased persons. The rate structure is probably too severe for a "young" country but the law is modern and the best there is. There are a few directions in which the system needs change. The Government and their officials are quite aware of them.

13. It is well established that few other national tax systems can compare with ours in simplicity of concept, adherence to principle and flexibility. At a recent international Tax Conference, it was stated in effect by a representative from abroad, that no country had been more prolific in supplying unique ideas for the solution of difficult tax problems than Canada. Canadian methods of dealing with certain awkward tax problems have been widely copied in other countries. In negotiating tax Conventions with other countries for



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1 the avoidance of double taxation, foreign government  
2 officials never fail to express amazement at the ease  
3 with which a working knowledge of the fundamentals of  
4 our tax laws is acquired. Probably few Canadians will  
5 believe this.

6 So much for background and perspective.

7 Does Income Tax Discourage Economic Activity,  
8 Saving and Investment?

9 14. It is not within the proper scope of this  
10 memorandum to undertake a general assessment of our tax  
11 structure as a whole, to argue whether on balance it  
12 is a good one or a bad one, whether it is fair or unfair.  
13 However, it is appropriate to the field of enquiry of  
14 the Commission to offer comment on whether our taxes  
15 have harmful effects on economic activity, on enterprise  
16 generally, on saving and capital formation in particular.  
17 Do taxes impair the capital marketing process as a  
18 mechanism in our society?

19 15. It is the fashion generally to assert that  
20 personal income tax discourages work, enterprise,  
21 ambition, saving and investment. Quite uncritically,  
22 this proposition finds pretty widespread acceptance.  
23 Possibly, there is some truth in it but it almost  
24 goes without saying that the bad effects of taxes will  
25 be greatly exaggerated.

26 16. During the last war when income taxes were  
27 pushed so high so quickly, the Minister of Finance  
28 received quite a volume of letters from employers com-  
29 plaining about the difficulty of getting men to work  
30 overtime, weekends or even for a full week. Absenteeism



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THE COMMISSION'S RECOMMENDATIONS

14. It is not within the proper scope of this memorandum to undertake a general assessment of our tax structure as a whole, to argue whether or not it is a good one or a bad one, whether it is fair or unfair. However, it is appropriate to the field of enquiry of the Commission to offer comment on whether our taxes have harmful effects on economic activity, on enterprise generally, on saving and capital formation in particular. To taxes impair the capital marketing process as a mechanism in our society?

15. It is the fashion generally to assert that personal income tax discourages work, enterprise, ambition, saving and investment. Quite unthinkingly, this proposition finds pretty widespread acceptance. Possibly, there is some truth in it but it almost goes without saying that the bad effects of taxes will be greatly exaggerated.

16. During the last war when income taxes were pushed so high so quickly, the Minister of Finance received quite a volume of letters from employers complaining about the difficulty of getting men to work overtime, weekends or even for a full week. Absenteeism



1 was quite bad in spots. Employers blamed the high tax,  
2 deducted at the source (for the first time) - a higher  
3 rate was withheld as earnings per pay-period increased.  
4 Undoubtedly, the tax plus forced savings caused  
5 considerable resentment - many never believed they would  
6 get back their forced savings - and slacked off in  
7 effort as a result. But it should be remembered that  
8 coupled with the high tax were unusually high levels of  
9 earnings beyond what many were accustomed to. Good  
10 jobs were a certainty and it is not too surprising that  
11 tax resentment plus ample security led to some indif-  
12 ference to unusual effort.

13 17. In recent years when jobs are relatively  
14 scarcer and more highly prized, one never hears of  
15 refusal or reluctance to work in the lower or middle in-  
16 come groups. The tax is now fairly low in these  
17 brackets and deduction at the source is taken as a  
18 matter of course without comment. After all, with an  
19 average industrial wage of only about \$75 a week the  
20 tax taken from a married man with two children is only  
21 \$3.65 a week. However, with a pay increase up to \$100  
22 a week, his tax would increase to \$8.25 a week, leaving  
23 him only \$20.75 better off out of a \$25 pay increase.  
24 This is the sort of result from a steeply graduated  
25 tax that can cause some concern among high bracket wage  
26 and salary workers. Probably, however, for ordinary  
27 routine work a man will try about as hard for promotion  
28 and pay increase as he would in the absence of income  
29 tax. It is likely that the tax angle will be looked  
30 at more closely, however, by a person who has a chance





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17. In recent years when jobs are relatively scarcer and more highly prized, one never hears of refusal or reluctance to work in the lower or middle income groups. The tax is now fairly low in these brackets and deduction at the source is taken as a matter of course without comment. After all, with an average industrial wage of only about \$75 a week the tax taken from a married man with two children is only \$16 a week. However, with a pay increase up to \$100 a week, his tax would increase to \$36.25 a week, leaving him only \$63.75 better off out of a \$65 pay increase. This is the sort of result from a steeply graduated tax that can cause some concern among high bracket and salary workers. Probably, however, for ordinary routine work a man will try about as hard for promotion and pay increase as he would in the absence of income tax. It is likely that the tax angle will be considered more closely, however, by a person who has a choice

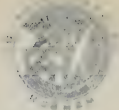


1 to make a break and move to a higher paid job elsewhere.  
2 He may decide that the after-tax benefit does not quite  
3 justify the risk and trouble of moving his household.  
4 This, of course, is not good and there must be quite a  
5 number of cases of it.

6 18. About  $5\frac{1}{2}$  million people in Canada file income  
7 tax returns. Of these about 5 million never encounter  
8 a marginal rate of tax (tax on increases in earnings)  
9 of 25%. Perhaps then it can be said that this group  
10 (plus those who do not even file returns), making up  
11 over 90% of the workers in Canada, do little if any less  
12 work because of income tax. Probably in few cases will  
13 ambition to improve their lot and accordingly the lot of  
14 the community be dimmed by income tax.

15 19. If the above generalization is somewhere near  
16 correct, then it might be held that income tax is not  
17 quite so bad as it is made out to be. However, there  
18 are about half a million tax payers whose marginal rate  
19 of tax is above 25% and above this point the rates in-  
20 crease quite steeply quite soon. The rate is 35% on  
21 taxable income above \$10,000, 40% above \$12,000, 45%  
22 above \$15,000, 50% above \$25,000 and 55% above \$40,000  
23 and so on. It is within these income ranges, the top  
24 10%, that the potential bad effects of income tax will  
25 be expected.

26 20. It is a great temptation to simply assert in  
27 strong terms that of course our high tax rates are  
28 stultifying, that they take way inclination to work hard  
29 for promotion and extra gain, undermining ambition to  
30 get ahead and willingness to risk going out on a limb



to make a break and move to a higher paid job elsewhere. He may decide that the after-tax benefit does not quite justify the risk and trouble of moving his household. This, of course, is not good and there must be quite a number of cases of it.

18. About 5½ million people in Canada file income tax returns. Of these about 5 million never encounter a marginal rate of tax (tax on increases in earnings) of 25%. Perhaps then it can be said that this group (plus those who do not even file returns), making up over 90% of the workers in Canada, do little if any less work because of income tax. Probably in few cases will ambition to improve their lot and accordingly the lot of the community be dimmed by income tax.

19. If the above generalization is somewhere near correct, then it might be held that income tax is not quite so bad as it is made out to be. However, there are about half a million tax payers whose marginal rate of tax is above 25% and above this point the rates increase quite steeply quite soon. The rate is 25% on taxable income above \$10,000, 40% above \$12,000, 45% above \$15,000, 50% above \$25,000 and 55% above \$40,000 and so on. It is within these income ranges, the top 10%, that the potential bad effects of income tax will be expected.

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1 for success and generally that they kill the urge to  
2 follow the natural instincts of an enterprising spirit.  
3 Certainly they cause widespread resentment. But those  
4 who have seriously attempted to verify and give sub-  
5 stance to these easy generalizations have not been too  
6 successful.

7 21. Some years ago, Professor G.F. Break (U.S.)  
8 made a study in the U.K. of income tax and incentive  
9 and published it in the American Economic Review,  
10 September 1957. The results were by no means con-  
11 clusive even for the U.K., where income tax is much  
12 more severe than here. Professor Break apparently found  
13 about as many cases where more time, zeal and energy  
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15 good public schools for the children) because of the  
16 inroads of income tax as there were instances of  
17 defeatism and the inclination to say what the hell's  
18 the use and take it easy. One cannot, of course, be  
19 sure that the less conventional and presumably less  
20 supine? Canadian temperament would show the same  
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23 all its works in Canada is pretty appalling. Too soon,  
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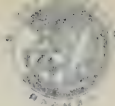
1 many which over the past years have poured in over the tax  
2 policy desk in the Department of Finance, has been on  
3 behalf of young business executives. The claim was that  
4 because of income tax they constantly tend to play it  
5 safe, that they seem to lose the spirit that may make  
6 or break them, knowing presumably that if it makes them,  
7 the rewards will be sadly depleted by obligations to the  
8 Receiver-General. So, it is held, they play it cozy,  
9 which is an abomination unto progress.

10 24. One might be more impressed with the claims  
11 in the preceding paragraph were it not so obviously  
12 the prevailing fashion among bright young businessmen  
13 to worship status and all its symbols. As things are,  
14 it is not too easy to visualize among them any wide-  
15 spread indifference to work, promotion, rank and title  
16 because of the unconscionable swipe at the pay envelope  
17 taken by the government.

18 25. All in all, not a very good case can be made  
19 for claiming that the gross national product in Canada  
20 today is much less than it would be in the absence of  
21 the effects of personal income tax on the economic  
22 activity of individuals.

23 26. Does personal income tax affect the willing-  
24 ness of people to save capital for investment? That  
25 is, does the tax on income in the form of interest,  
26 dividends, rents and royalties discourage the process  
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1 of funds saved out of income within a community is not  
2 very responsive to the return on it. If this is so,  
3 it follows that a tax which reduces the effective yield  
4 will not greatly affect the willingness of the public to  
5 save.

6 27. A very large part of income from investment of  
7 savings in Canada is not subject to income tax in any  
8 case. For example -

9 (a) Income from an investment in a house occupied  
10 by the owner bears no tax in Canada. For the  
11 sake of equal treatment between taxpayers, it  
12 should be. Imputed rent is taxed to the owner-  
13 occupier in U.K. and Australia for example,  
14 but not in Canada.

15 (b) Earnings on all insurance-endowment policies,  
16 credited to or received by policyholders at  
17 maturity, never bear income tax. Furthermore,  
18 the insurance company itself is not taxed  
19 on its investment income, but only on the  
20 amount transferred to shareholder account, if  
21 indeed, it has shareholders. Mutuels pay no  
22 income tax at all. The accumulated earnings  
23 on a single premium 40-year endowment policy  
24 come to the policyholder for spending, un-  
25 touched by income tax. Interest accumulations  
26 on annuity policies likewise bear no tax up  
27 to the time of the commencement of the annuity.

28 (c) Interest and dividend accumulations in all  
29 government, industrial and private pension  
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(b) Earnings on all insurance-endowment policies credited to or received by policyholders at maturity, never bear income tax. Furthermore, the insurance company itself is not taxed on its investment income, but only on the amount transferred to shareholder account. If, indeed, it has shareholders, Mutuals pay no income tax at all. The accumulated earnings on a single premium 40-year endowment policy come to the policyholder for spending, untouched by income tax. Interest accumulations on annuity policies likewise bear no tax up to the time of the commencement of the annuity.

(c) Interest and dividend accumulations in all Government, industrial and private pension plans and registered retirement savings





1 plans, escape tax up to the date of maturity  
2 of the pension and even when received in  
3 pension, form little or no tax is payable in  
4 a large proportion of cases because of  
5 personal exemptions.

6 (d) Much of the coupon interest on ordinary  
7 government bonds escapes income tax simply  
8 because it is not reported.

9 28. All in all, there is a pretty lusty annual  
10 crop of investment income in Canada that completely  
11 escapes the income tax net. In this sense, there is  
12 a quite substantial tax incentive for the accumulation  
13 of capital here for investment.

14 29. As against the above favourable factors, the  
15 volume of capital accumulation in Canada is very  
16 adversely affected by the pattern of our tax structure  
17 and through the use of taxation in financing the para-  
18 phernalia of the welfare state. The redistribution of  
19 income in the community from those who otherwise might  
20 be expected to save and invest, down to those who might  
21 not be expected to save and invest, is adding up these  
22 days to a pretty impressive volume of money. It is  
23 scarcely any wonder that Canadians are making no  
24 progress toward repurchasing ownership of Canadian  
25 industry from foreigners and that they will have to  
26 sell their bonds abroad in considerable volume annually  
27 to secure funds for capital investment in Canada.

28 30. Our personal income tax structure is graduated  
29 from 11% to 80%. If the graduation were abolished,  
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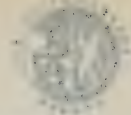


1 flat rate of tax of 16% on all taxable income. This  
2 fact reveals very clearly the futility of trying to  
3 help very much the general standard of living of labour  
4 groups by putting steeply graduated taxes on the medium  
5 and upper incomes. Canada is not a rich country in the  
6 sense of having a large number of well-to-do people  
7 with substantial investments. This fact has long been  
8 evident in the pitifully meagre returns from a special  
9 tax on investment income in Canada. Two decades of  
10 steeply graduated taxes have made capital accumulation  
11 by individuals very difficult. Our medium and upper  
12 income tax brackets are in fact very thinly populated.

13 31. Because of this situation, the annual loss  
14 of revenue to the Treasury through putting a ceiling of  
15 50% on personal income tax rates - i.e., chopping off  
16 the 55%, 60%, 65%, 70%, 75% and 80% rates - would be  
17 less than \$10 million. This sounds a bit unbelievable,  
18 but there it is. A rate ceiling of 40% applying to all  
19 taxable income in excess of \$12,000 would cost in  
20 revenue loss only about \$40 million. It is quite ob-  
21 vious that the income tax structure is a product of  
22 popular politics rather than of economic or even revenue  
23 considerations.

24 32. Social welfare is the largest item of govern-  
25 ment expenditure in Canada today. For all three levels  
26 of government, the amount currently spent adds up to  
27 about \$3 billion a year. This huge sum is by no means  
28 solely directed to the poor who need it but is poured  
29 out over everybody generally without a means test. Old  
30 age pensions, family allowances and hospital benefits





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25 ment expenditure in Canada today. For all these levels  
26 of government, the amount currently spent adds up to

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28 solely directed to the poor who need it but is poured  
29 out over everybody generally without a means test. Old

30 age pensions, family allowances and hospital benefits



1 go to nearly everybody regardless of income status. In  
2 a few provinces, the premium or contributory system is  
3 casually nodded to in financing welfare, but over-all,  
4 federal, provincial and municipal funds are mainly  
5 raised by taxes, which through wide income ranges are  
6 roughly proportional to income, or in the case of income  
7 taxes are away more than proportional to income in all  
8 ranges. It follows from this system of financing that  
9 always the majority - and not just the poor who need it  
10 - get something for nothing.

11 33. Generally speaking then, under our Canadian  
12 system of financing welfare expenditure, there is no  
13 relation between what a person contributes towards his  
14 social security and what he receives. Benefits are the  
15 same for all, but a person with twice the income of  
16 another will pay about twice the premium for his in-  
17 surance by the State. With then times the income, his  
18 premium will be about ten times as much. Under our in-  
19 come tax schedule, a man with \$2,000 taxable income  
20 pays \$250 tax, with five times as much income he pays  
21 eight times as much tax. With twenty times as much in-  
22 come he pays sixty-four times as much tax. Federal in-  
23 come tax is the largest single item in financing  
24 universal flat rate welfare benefits. With welfare ex-  
25 penditure of about \$3 billion, the redistribution of  
26 income through the taxing process in Canada runs into  
27 pretty impressive totals.

28 34. One can never be quite sure just what social  
29 philosophers have in mind when they advocate redistri-  
30 bution of incomes. It might mean merely that everybody



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1 above a certain level of income should contribute towards  
2 the aid of all unfortunates in the community who are in  
3 need, to those who from one cause or another find them-  
4 selves below what might be called the poverty line, in  
5 need of financial help either temporarily or permanently  
6 - the Jesus(?) - type of redistribution. No one should  
7 quarrel with this principle, and with a poverty line  
8 very generously drawn. In practice however, it works  
9 out that there is a general redistribution of income  
10 downward throughout the whole range of incomes so that,  
11 for example, the taxes of the \$10, \$20, \$50 or \$100  
12 thousand a year man are less than they otherwise would  
13 be because everybody above them pays more for the  
14 support of Government than they do.

15 35. This latter form of indirect general redistri-  
16 bution of income downward has, of course, been going on  
17 whenever and wherever graduated or proportional taxes  
18 have been in effect. It appears, however, that in  
19 Canada at least, there has never been an overt declared  
20 policy of redistributing incomes. It has merely been  
21 that taxes have been levied in such a way that redistri-  
22 bution has been the end result. Policy discussions, if  
23 any, have been confined to the manner of spreading the  
24 tax burden. This was all very natural and sensible  
25 when the greater part of government expenditure was for  
26 general services of an intangible nature, such as for  
27 defence, maintenance of order, courts, legislative and  
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1 benefits directly from these government services and it  
2 has been generally accepted that under the circumstances  
3 taxes should be levied according to "ability to pay".

4 36. Canada seems to have moved quite easily and  
5 comfortably into the concept of the Welfare State. And  
6 it seems that almost without policy debate in Parliament  
7 on the principles to be followed in paying for it, we  
8 have drifted into the politically expedient method of  
9 pooling the cost. In effect the politicians have sug-  
10 gested we all get together and in family fashion look  
11 after each other's old people, the having of babies,  
12 hospitalization for chicken pox, broken arms and legs,  
13 bad appendixes and so on - the host of normal expenses  
14 that in all income brackets we all expect to have to  
15 meet sooner or later as we move along with daily living.

16 37. We have not in Canada adhered to the insurance  
17 principle as some other countries have, nor have we  
18 followed the contributory system with the State merely  
19 setting up the machinery under which most would be in-  
20 duced through premiums to make provision for themselves.  
21 We have not insisted generally on means tests with the  
22 State filling in where the individual is unable to  
23 provide. One hears quite frequently in Canada the view  
24 that means tests are embarrassing, undignified and old-  
25 fashioned, that state benefits - transfer payments -  
26 should be a matter of right.

27 38. The purpose of the foregoing is not to indulge  
28 in a futile diatribe against the majority in our  
29 democracy who directly benefit by this system and give  
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1 Rather it is to call attention to a by-product of this  
2 situation where across the board huge sums are taken  
3 from those who otherwise could accumulate capital for  
4 investment and are passed down for spending by those  
5 who cannot be expected to save capital for investment.

6 39. It is frequently stated these days that as a  
7 nation we are living beyond our means. Of course the  
8 majority of our people are actually living beyond their  
9 own means, through transfer payments of cash and  
10 services which belonged to other people, effected by  
11 the tax system. Accordingly, individual saving by the  
12 majority for capital investment which the nation needs  
13 is under a pretty severe handicap and it gets worse  
14 every year.

15 40. Whether because of the relative scarcity of  
16 investment, capital forthcoming from individuals because  
17 of the inroads of taxes or for other reasons, the fact  
18 is a very large proportion of the capital for industrial  
19 and commercial expansion in Canada is supplied upstairs  
20 by corporations themselves from undistributed profits.  
21 In this manner, profits of the industrial system never  
22 have to pass through the personal income tax net (al-  
23 though, of course, the corporate tax applies). Further-  
24 more, with no tax on capital gains, the equity value  
25 added through ploughing back earnings can be realized  
26 by the shareholder tax free through subsequently selling  
27 out. This development, to some extent, has circumvented  
28 the general adverse effects of the tax system on capital  
29 accumulation.

30 41. This ploughing back of earnings in existing



it is to call attention to a by-product of this  
attention where across the board taxes are taken  
from those who otherwise could accumulate capital for  
investment and are passed down for spending by those  
who cannot be expected to save capital for investment.  
It is frequently stated these days that as a  
nation we are living beyond our means. Of course the  
majority of our people are actually living beyond their  
own means, through transfer payments of cash and  
services which belonged to other people, effected by  
the tax system. Accordingly, individual saving by the  
majority for capital investment which the nation needs  
is under a pretty severe handicap and it gets worse  
every year.

40. Whether because of the relative scarcity of  
investment, capital forthcoming from individuals because  
of the imbrade of taxes or for other reasons, the fact  
is a very large proportion of the capital for industrial  
and commercial expansion in Canada is supplied upstair  
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the general adverse effects of the tax system on capital  
accumulation.

41. This ploughing back of earnings in existing





1 businesses, it might be argued, tends merely to perpetu-  
2 ate existing firms making them into larger and larger  
3 units and does not in any way help to bring along new  
4 enterprises in the same or entirely different kinds of  
5 business. This generally is true but there are, how-  
6 ever, encouraging signs that new financial institutions  
7 may develop which will specialize in this very field of  
8 financing new small industries. Again, there is scope  
9 here for the use of upstairs venture capital in short-  
10 circuiting the personal income tax obstacle.

11 42. To this point, the income tax on individuals  
12 has been looked at in an attempt to assess broadly its  
13 effects on economic activity in the community, on the  
14 willingness and more particularly the ability of people  
15 to save and invest. We now come to the tax on corporate  
16 profits, that amazing phenomenon in the capitalistic  
17 system that has become so solidly entrenched in govern-  
18 ment revenue systems over the past two decades. It is  
19 as near the truth as makes no difference to say that  
20 over the past two decades, taxes on corporate incomes  
21 have on this continent (Canada and the U.S.), taken  
22 away about half the profits of the capitalist industrial  
23 system. If not long ago one had asked an economist  
24 what would happen if taxes took away half the rewards  
25 of capital investment under our system, he would blandly  
26 and with certainty have answered that there would soon  
27 be no private enterprise system left, that new invest-  
28 ment would wither away and that the system would  
29 rapidly grind to a halt. And how wrong he would have  
30 been. The fact is, of course, that under these

businesses, it might be argued, tends merely to perpetuate existing firms making them into larger and larger units and does not in any way help to bring along new enterprises in the same or entirely different kinds of business. This generally is true but there are, however, encouraging signs that new financial institutions may develop which will specialize in this very kind of financing new small industries. Again, there is some hope for the use of upstarts venture capital in short-circuiting the personal income tax obstacle.

42. To this point, the income tax on individuals has been looked at in an attempt to assess roughly the effects on economic activity in the community, on the willingness and more particularly the ability of people to save and invest. We now come to the tax on corporate profits, that amazing phenomenon in the capitalist system that has become so solidly entrenched in government revenue systems over the past two decades. It is as near the truth as makes no difference to say that over the past two decades, taxes on corporate incomes have on this continent (Canada and the U.S.), taken away about half the profits of the capitalist industrial system. If not long ago one had asked an economist what would happen if taxes took away half the rewards of capital investment under our system, he would blabber and with certainty have answered that there would soon be no private enterprise system left, that new investment would wither away and that the system would rapidly grind to a halt. And how wrong he would have been. The fact is, of course, that under these



1 conditions we have witnessed the greatest investment  
2 boom that this country has ever experienced. This  
3 takes some explaining.

4 43. Of course it is known that the post-war  
5 period was one of pent-up demand, with scarcities over  
6 wide ranges and that this naturally brought on new in-  
7 vestment on a huge scale. But even so, one is entitled  
8 to some doubt that this boom would have gone on so  
9 merrily had not investors seen the opportunity of good  
10 profits at accustomed levels after tax from their new  
11 plant and equipment. From this, it does seem to be a  
12 fair assumption that the main burden of the 50% cor-  
13 porate tax was being passed on in higher prices.

14 44. Generally in the post-war period it was a  
15 sellers' market. It was the ordinary thing for business  
16 generally to operate with a heavy volume of unfilled  
17 orders. Under these conditions it would not be too  
18 difficult to edge prices up slightly, to recoup the tax  
19 on profits. And prices would only have to be moved up  
20 slightly to accomplish this. Over industry as a whole  
21 the profit take averages only about 5% on gross sales.  
22 Thus, just a few percentage points of gradual upward  
23 adjustment in prices would replace in profit and loss  
24 account the additional amount taken out by the govern-  
25 ment. It would work out this way quite easily if all  
26 firms in an industry followed their inclinations in this  
27 direction - and they probably would.

28 45. It is the generally accepted principle in  
29 business costing and pricing policy for new products in  
30 calculating whether new investment in a certain direction





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INDUSTRY RECOVERY

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period was one of post-war boom, with conditions over  
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vestment on a huge scale. But even so, one is entitled  
to say that the post-war boom was a boom in the  
merchandise had not investors seen the opportunity of good  
profits at accustomed levels after tax from their new  
investments. It is true that the post-war boom was a boom  
in the merchandise market, but the main burden of the post-war  
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direction - and they probably would.

It is the generally accepted principle in  
business costing and pricing policy for new products in  
calculating whether new investment in a certain direction



1 is worthwhile to look at the after-tax margin. Cor-  
2 porate tax is treated in exactly the same manner as  
3 federal sales tax - just another cost to be recovered  
4 in prices. Almost universally, businessmen admit that  
5 they recoup themselves the corporate tax out of prices.  
6 "How else do you think we stay in business", they say.

7 46. The lack of any clear generally accepted  
8 theory of the incidence of the corporate tax these days  
9 completely bedevils all discussion of the effects of  
10 the tax on business activity and new capital investment.  
11 And the disconcerting fact is that scarcely anyone who  
12 professes a theory will accept the logical implications  
13 of it. It is a mess!

14 47. Businessmen who admit they recoup the tax  
15 in higher prices will mourn on public platforms over  
16 the weight of the tax burden on them - and they are  
17 not grieving over a slightly lessened sales volume  
18 because their prices are a few percentage points higher  
19 than they otherwise would have to be. Some years ago,  
20 a dividend tax credit was given by the Government to  
21 partially remove so-called double taxation on the  
22 shareholder. From the same forum, it was subsequently  
23 asserted that the tax is passed on to consumers in  
24 higher prices, that it is in effect just another sales  
25 tax and that the CCF party were just fooling themselves  
26 in advocating higher corporate taxes.

27 48. On the corporate tax is blamed the inadequacy  
28 of profits for reinvestment and the difficulty of  
29 raising outside equity money. On all sides it is held  
30 that the high tax on business is killing initiative,

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1 economic growth and development.

2 49. It has been the fashion in the past for text-  
3 book deductive lore on this subject to hold that since  
4 the tax is on profits only after they are realized, it  
5 cannot be a cost factor influencing prices from which  
6 profits are calculated. The marginal analysis is then  
7 brought in for greater certainty to show that since  
8 prices are determined at the margin by producers who  
9 make no profit, therefore, a tax on profits cannot  
10 possibly enter into price and accordingly, must come  
11 straight out of the hides of the owners of intra-  
12 marginal producers.

13 50. If classical theory is right, then business  
14 profits available for dividends in Canada are annually  
15 about \$1½ billion less than they would be in the ab-  
16 sence of a tax on corporate profits. Prices are no  
17 higher because of the tax so the volume of sales is un-  
18 affected by it. It would likewise seem to follow under  
19 this theory that the incentive to invest is very sub-  
20 stantially impaired by the corporate tax and, therefore,  
21 it must be a severe penalty on business growth and  
22 development.

23 51. If businessmen are right in claiming that the  
24 corporate tax is treated as a cost and generally in-  
25 cluded in price, then the volume of profits available  
26 for dividends to shareholders is unimpaired by the tax,  
27 prices are just a little bit higher but the incentive  
28 to invest and the funds available for investment are  
29 scarcely touched at all by the tax.

30 52. In the face of these two sharply conflicting



economic growth and development.

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 prices are determined at the margin by producers who  
 make no profit, therefore, a tax on profits cannot  
 possibly enter into price and accordingly, must come  
 straight out of the hides of the owners of intra-  
 marginal producers.

50. If classical theory is right, then business  
 profits available for dividends in Canada are annually  
~~about 10 per cent of the value of the business~~  
 since of a tax on corporate profits. Prices are no  
 higher because of the tax so the volume of sales is un-  
 affected by it. It would likewise seem to follow under  
 this theory that the incentive to invest is very slightly  
substantially impaired by the corporate tax and, therefore,  
 it must be a severe penalty on business growth and  
 development.

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 corporate tax is treated as a cost and generally in-  
 cluded in price, then the volume of profits available  
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52. In the face of these two sharply conflicting



1 views on the incidence of the corporate tax, one is  
2 supposed here in this memorandu, to say what its effects  
3 are on economic growth and the capital market in Canada.  
4 The conclusion in this memorandum is that the business-  
5 man's view is much nearer the truth than the deductive  
6 case put forward in classical theory. If the text-book  
7 theory were mainly right, it seems to prove too much.  
8 With pre-war tax of 10%-13%, it is a bit hard to see  
9 businessmen accommodating themselves so easily to the  
10 remnant left after 50% is taken away. Businessmen seem  
11 to have a pretty strong conventional sense of what is  
12 worth going after and they will quite readily decide  
13 not to attempt a line that cannot be sold at a price  
14 to give a reasonable profit after all costs including  
15 corporate tax are recovered. It certainly does not  
16 seem that there has been much holding back in Canada  
17 over the past two decades. There has in fact been a  
18 pretty wholesome spirit of enterprise with good profit  
19 margins generally in most directions. This is hard to  
20 reconcile with a strict belief that the incidence of  
21 the corporate tax over this period has been on the owner  
22 of business enterprises. The actual facts of what has  
23 happened seem far more acceptable if one assumes that  
24 pretty generally as a matter of ordinary business pro-  
25 cedure in pricing policy, that the tax is passed on in  
26 slightly higher prices.

27 53. In recent years we have seen in Europe a  
28 very substantial business expansion, with new investment  
29 passing all previous records. This has taken place under  
30 systems of corporate tax burdens in European countries





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very substantial business expansion, with new investment  
... systems of corporate tax burdens in European countries



1 not much less than those prevailing on this continent.

2 54. Of course, in regulated industries such as  
3 the railways and telephone companies, the corporate tax  
4 is quite openly passed on to consumers. In arguing for  
5 rate increases, Bell Telephone for example, argues that  
6 in order to attract new capital they have to maintain  
7 certain dividend rates. In order to pay an additional  
8 \$1 in dividends, they have to have an increase of \$2  
9 in their profits. They then argue for rate increases  
10 which will give this \$2 profit so that after tax \$1  
11 will be left for dividends. The Board of Transport  
12 Commissioners agree with this argument and grant the  
13 rate increases, which, of course, includes the piece to  
14 cover corporate tax. Ordinary uncontrolled business  
15 does not have this arbitrary price fixing but it is a  
16 fair assumption that businessmen pretty much auto-  
17 matically reason in the same manner as the regulated  
18 companies and universally act accordingly.

19 55. It is perhaps not very good evidence, but  
20 it might be worth recording that in war-time with an  
21 excess profits tax in force it was very common for  
22 businessmen to state that they would much prefer a  
23 straight flat rate tax up to 60% or more on total  
24 profits, rather than a 40% minimum, with 80% of 100%  
25 on the excess, with 20% refundable. With a flat rate  
26 tax, pricing was simple and they knew where they were.  
27 Also it might be noted that after the war, there was  
28 little, if any, real pressure back of protests against  
29 the corporate tax which took away about half of business  
30 profits. The business world accepted this scale of



24. Of course, in regulated industries such as the railways and telephone companies, the corporate rate is quite openly passed on to consumers. In arguing for rate increases, Bell Telephone for example, argues that in order to attract new capital they have to maintain certain dividend rates. In order to pay an additional \$1 in dividends, they have to have an increase of \$2 in their profits. They then argue for rate increases which will give this \$2 profit so that after tax \$1 will be left for dividends. The Board of Transport Commissioners agree with this argument and grant the rate increases, which, of course, includes the pass to cover corporate tax. Ordinary uncontrolled business does not have this arbitrary price fixing but it is a fair assumption that businessmen pretty much automatically reason in the same manner as the regulated companies and universally act accordingly.

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1 taxation without any very vigorous protest. Surely  
2 they would not have done so had it meant that profits  
3 were reduced from what they were used to by the amount  
4 of the tax. It does seem as if business were taking  
5 care of itself quite adequately and did not have the  
6 nerve to squawk as they might have otherwise been ex-  
7 pected to do.

8 56. Personal income taxes were successively  
9 slashed after the war. Most special excise taxes were  
10 either abolished or reduced. The federal sales tax  
11 was not lowered after the war, but then it was never  
12 increased during war time, and it stands at the same  
13 level today as it did in the thirties (old age security  
14 tax of 3% has been added to it). But the tax on corpo-  
15 rate profits has never receded from its war time peak  
16 either here or in the U.S. True, it is politically an  
17 easy tax to put on and a hard one to take off, but even  
18 so, if it were as harmful as text-book theory makes it  
19 out to be, it is doubtful if it could have survived at  
20 present levels for so long nor, it is suggested, could  
21 the capitalist system on this continent have flourished  
22 as it has during the period of high taxation.

23 57. So, biting the hand that feeds him these days,  
24 the writer of this memorandum concludes as a general  
25 proposition that corporate tax is mainly passed on to  
26 consumers, that industrial and commercial profits in  
27 Canada are not appreciably less than they would be with  
28 no tax on corporate profits, that prices are slightly  
29 but not much higher, that the incentive to invest and  
30 the capital available for investment have not been



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no tax on corporate profits, that profits are slightly



1 appreciably impaired because of it, briefly, that gross  
2 national product in Canada is about what it would be if  
3 the same volume of corporate tax revenue had been col-  
4 lected in some other way, say, by means of sales taxes  
5 on commodities and services generally.

6 58. Recently the Canadian Tax Foundation has  
7 published a Tax Paper under the title "The Burden of  
8 Canadian Taxation". It was written by Professor Irving  
9 Jay Goffman, a Montrealer now at the University of  
10 Florida. It is an excellent piece of work, the type of  
11 study long needed in Canada.

12 59. One very creditable thing about Professor  
13 Goffman is that he is not satisfied, as so many writers  
14 on this subject have been, with fuzzy indefinite state-  
15 ments. There is no pussyfooting in his conclusions  
16 about the incidence of the corporate tax. He says pre-  
17 cisely what he thinks. Here is what he ends up with:

18 ".....it seems reasonable to divide up and  
19 distribute the total burden of the corporate  
20 profit's tax in the following manner: 55% was  
21 borne by profits, 30% was passed on to consumers  
22 through higher prices, and 15% was shifted to  
23 workers in the form of lower wages. But these,  
24 of course, are only judgments of the writer,  
25 based on qualitative rather than quantitative  
26 analyses".

27 60. Without attempting any further argument, the  
28 opinion is expressed here that Professor Goffman's views  
29 are quite out of line and that about 90% is passed on to  
30 consumers, 10% on shareholders and none on wage earners.





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opinion is expressed here that Professor Goltman's views

are quite out of line and that about 90% is passed on to

consumers, 10% on shareholders and none on wage earners.



1 61. In the preceding paragraph it is stated as  
2 a general proposition that the corporate tax is mainly  
3 passed on to consumers. This, of course, may not be  
4 completely accomplished in all industries at any point of  
5 time nor completely true for any particular industry  
6 throughout the cycle of recession and recovery. But  
7 even if in some instance the tax remained on the cor-  
8 poration, it cannot automatically be assumed that this  
9 would mean much by way of discouragement to new  
10 investment.

11 62. Decisions regarding new investment are made  
12 upstairs by the management and submitted to directors  
13 of the corporations for approval. It is true that the  
14 directors are the trustees of the interests of the share-  
15 holders. In practice, of course, they tend to see the  
16 interests of the shareholders being pretty adequately  
17 looked after if they can make the business grow. In  
18 the cult of modern business, it is practically an  
19 article of faith that the only alternative to growth and  
20 expansion is a lingering death. In this view there can  
21 be no standing still. To halt is to perish. Growth is  
22 the price of survival. New inventions bring obsolescence  
23 in their train practically compelling new capital outlays.  
24 Values of existing assets can be maintained only by  
25 modernization involving new capital expenditure.  
26 Pressures within a dynamic economy constantly override  
27 the cautious calculations of the financially-minded who  
28 tend to be preoccupied with close percentage yields.  
29 Most of the urgent drive for the bigger, better and  
30 faster ignores the unpleasant fact of having to share



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1 with the government the fruits of success in broader  
2 fields of activity. New records of greatness pass as  
3 proof of the soundness of progressive management.

4 63. In Canada - in the past at least - capital  
5 expenditure in finding and developing new sources of  
6 minerals and energy has tended to set the pace for  
7 country-wide business expansion. Here the main driving  
8 force is not immediate profits carefully calculated as  
9 a percentage on new investment. More likely it is the  
10 fear of future scarcities and the urge to acquire in-  
11 ventory in the ground to give security for the mainten-  
12 ance of future operations. Natural resource develop-  
13 ment in Canada has largely become empire building. The  
14 immediate level of profits and taxes thereon is not too  
15 significant.

16 64. Within this milieu of compulsions and  
17 urgencies in both primary and secondary industry, are  
18 obvious grounds for caution in accepting too readily  
19 easy generalizations about the effect of high corporate  
20 taxes on venturesome capital. The diverse mixture of  
21 motives and circumstances governing investment decisions  
22 in a growing country defeat the search for simple con-  
23 clusive answers. He who holds forth on the crippling  
24 effects of corporate taxes can doubtless mention parti-  
25 cular situations where the thin margin of profit after  
26 tax has discouraged some people from embarking on an  
27 otherwise sensible extension to their businesses. Big  
28 shots in the mining industry will assert with some  
29 horror that high corporate taxes convert valuable ore  
30 into waste rock and it is probably true that some low

with the government the fruits of success in broader fields of activity. New records of greatness pass as proof of the soundness of progressive management.

expenditure in finding and developing new sources of minerals and energy has tended to set the pace for the world. Here the main driving force is not immediate profits carefully calculated as a percentage on new investment. More likely it is the fear of future scarcities and the urge to secure inventory in the ground to give security for the maintenance of future operations. Natural resource development in Canada has largely become empire building. The immediate level of profits and taxes thereon is not too significant.

64. Within this milieu of compulsions and urgencies in both primary and secondary industry, are obvious grounds for caution in accepting too readily easy generalizations about the effect of high corporate taxes on venturesome capital. The diverse mixture of motives and circumstances governing investment decisions is a complex matter. He who holds forth on the crippling effects of corporate taxes can doubtless mention particular situations where the thin margin of profit after tax has discouraged some people from embarking on an otherwise sensible extension to their businesses. Big

shots in the mining industry will assent with some horror that high corporate taxes convert valuable ore into waste rock and it is probably true that some low



1 grade bodies may be by-passed irrevocably because of the  
2 low residual profit after tax. An inaccessible stand  
3 of merchantable timber may be left to deteriorate into  
4 worthless old trees because there is not enough in it  
5 after tax to justify the risks involved in organizing  
6 a show to take it out. But for the high tax on profits  
7 it might have seemed worth doing.

8 65. There is some substance in these assertions  
9 and they deserve some attention but broadly considered  
10 these relatively minor instances of discouragement to  
11 action should not be blown up as a fundamental criticism  
12 of the system.

13 66. There are, of course, bad by-products of a  
14 tax of which it can be said in charging items to p & l  
15 that half the cost comes out of the government anyway.  
16 Also it is not denied that a cut in corporate taxes  
17 would give a real, if temporary, lift to business. It  
18 would greatly improve this so-called climate and the  
19 business world would with one accord agree that at last  
20 they had a Government in Ottawa that understood their  
21 problems. It would really help but it would take a  
22 courageous government to do it.

23 67. If the above conclusions are generally ac-  
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25 Canadian export sales are badly inhibited by our high  
26 tax on profits therefrom in competition with other  
27 countries. It seems, however, that business men the  
28 world over look on the corporate tax in their own  
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30 that moving from domestic to foreign trade does not





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1 alter the situation very much - they all still try to  
2 pass on the tax.

3 68. The implication of this situation is that al-  
4 though Canadian producers may not suffer much positive  
5 tax disadvantage in international competition, a lower-  
6 ing of our corporate tax would improve their competitive  
7 position abroad. It is against the rules of GATT to  
8 give tax incentive abatement on profits from export  
9 sales as such but a lowering across the board would  
10 help. The loss of revenue could be picked up through  
11 sales tax which does not apply to goods exported - a  
12 standard rule. This would seem to be good national  
13 policy for Canada. It would not make much sense, how-  
14 ever, to those who believe that the incidence of the  
15 corporate tax is mainly on the shareholders and not on  
16 the purchasers.

17 69. In the U.S. the tax is 52%, in the U.K. it  
18 is 38 $\frac{1}{4}$ % plus 10%. Generally in continental Europe  
19 corporate taxes are not appreciably less than ours.  
20 Canadian business men after trips to Europe, however,  
21 are inclined on return to hold forth pretty vigorously  
22 about the tax incentives that are offered to their  
23 competitors by governments abroad. Actually the in-  
24 centives are very few and not too important.

25 70. After having considered the individual income  
26 tax and the corporate tax separately, comment might be  
27 made on those who in an analysis of our system bring  
28 together the combined effects of the two taxes. It is  
29 shown, for example, that 50% comes out of the dollar  
30 earned by the corporation and that another,

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say, 70% (less 20% tax credit) comes out of the shareholder dividend, leaving only 25 cents to the original investor from the dollar of profits earned by his investment. This sort of assumed result is supposed to show that our system is pretty vicious and practically impossible. If this were the practical result in the ordinary case it certainly would be.

71. This however, seems scarcely a realistic way of setting forth the incidence of taxes on the ordinary investor who, say, decides to buy a few shares on the market. Here the adverse effects (if any) of the corporate tax on the profits of the company will already have been reflected in the market value of the shares. The new investor buys in on a yield basis of market price in relation to dividends after corporate tax. So it cannot be said that the corporate tax takes 50% out of the profit dollar earned on his investment. It was already out before he invested. As for personal income tax, if his marginal rate is 70% it will be 50% after the tax credit. However, if his corporation follows normal practice, it will pay out to the investor only about half the earnings his investment has bought, the other half will be retained and will add to the net worth and future income of his investment. If, as is to be expected, this growth is reflected subsequently in market values, our investor can realize on it at any time tax free. In effect he will have obtained without any tax at all the value of half the income from his original investment. He will have paid 50% tax on half the income of 25 cents out of the

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1 dollar earned on his investment, which is not too bad  
2 for a man in the \$125,000 income bracket (the 70% rate  
3 starts at this point).

4 72. As for the person who participates in the  
5 original financing of a new venture (or the extension  
6 of an existing one) the calculation of expected return  
7 will always be on an after tax (corporate) basis. It  
8 is true that 50% of gross profit will be taken in tax  
9 but pricing will be set up so that the net profit will  
10 remain as the expected return on the dollar invested.  
11 It is scarcely true to say in the circumstances that  
12 the corporate tax cuts in half the earnings on invest-  
13 ment when this half is already set aside as a reserve,  
14 as it were, for the government and allowed for in making  
15 the investment.

#### 16 The 20% Tax Credit for Dividends

17 73. At this point in the analysis of the effect of  
18 taxes on the capital market it is perhaps appropriate  
19 to have a look at the 20% credit given to individuals  
20 on dividends received. This move in government policy  
21 was preceded by some decades of pretty outspoken  
22 criticism by students of public finance both here and  
23 in the U.S. against the so-called double taxation in  
24 our revenue systems, where corporate earnings were  
25 taxed and the dividends out of these earnings were  
26 again taxed in full when received by the individual.  
27 It had long been the inclination of officials in the  
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1 Government was persuaded to make a start and gave in-  
2 dividuals a credit against their income tax bills of  
3 an amount equal to 10% of the dividends received from  
4 taxable Canadian corporations.

5 74. The main argument in support of this policy  
6 in Parliament was the removal of double taxation -  
7 mainly an argument of fairness. At the same time the  
8 corporate rate on small business was reduced to 10% on  
9 profits up to \$10,000. These two measures combined  
10 had the effect of completely removing so-called double  
11 taxation on three-quarters of all taxable corporations  
12 in Canada (not, however, on three-quarters of total  
13 corporate profits). Today the credit is 20% and the  
14 low rate of 21% tax applies to profits up to \$35,000.

15 75. The United States followed us some years  
16 ago with a very modest credit of 4%. However, the  
17 steam seems to have gone completely out of the strong  
18 sentiment which used to exist in the United States  
19 for this move. Possibly the loss of enthusiasm stems  
20 from the general realization that little, if any, double  
21 taxation actually exists, that the burden of the cor-  
22 porate tax is generally passed on in higher prices  
23 rather than back on the shareholder. In Canada the  
24 second move from 10% to the present 20% was never  
25 defended in Parliament on double taxation grounds.  
26 Rather it was declared to be encouragement for Canadians  
27 to acquire a greater stake in their own industry, to  
28 improve the market for equities and generally to be a  
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2 they are or what they accomplish. Always, however,  
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6 sarily very good argument against the tax device if it  
7 makes some appreciable headway towards the objective.

8 77. In this memorandum the 20% tax credit is  
9 firmly defended as a sound policy for Canada. It is  
10 openly nationalistic in its effects - the taxpayer gets  
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12 for, say, U.S. Corporate dividends. God knows we all  
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15 something about it. It would be a great thing if there  
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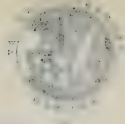


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10 79. As for objections to the dividend tax credit,  
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12 effective in accomplishing anything, is the fact that  
13 potentially it could give undue tax exemption. CCF  
14 members in the House have pointed out at times that  
15 a person with a \$10,000. income could escape income tax  
16 completely because of the 20% dividend tax credit. The  
17 case taken is one where the person's total income was  
18 dividends from Canadian taxable corporations. If these  
19 dividends were from mining or oil companies whose  
20 shareholders are entitled to depletion the figure for  
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22 answer to this criticism is that it is doubtful if there  
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24 remains on paper as a possibility. It could be corrected  
25 by a simple provision in the law stating that in no  
26 case should the tax credit reduce a person's total in-  
27 come tax liability by more than X% (say 50%).

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1 irrefundable and abates personal income tax up to a  
2 point to wipe out duplication. In the British system,  
3 on the other hand, the individual income tax is ir-  
4 reducible and relief is given in respect to the tax  
5 paid in by the corporation. Accordingly, in the U.K.  
6 if the standard rate paid in upstairs by the corporation  
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10 almost impossible administrative problem of refunding  
11 corporate tax to shareholders (where the upstairs rate  
12 exceeds the downstairs rate applying to shareholders),  
13 by giving relief in respect of the duplication caused  
14 by the downstairs tax rather than that caused by the  
15 upstairs one.

16 81. The U.K. tax paid by corporations is in  
17 principle merely deduction of standard income tax at  
18 the source just as we have deduction at the source from  
19 wages and salaries. Likewise in the U.K. the share-  
20 holder has to gross up his dividends just as we have  
21 to gross up wages and salaries and take into income  
22 for tax purposes what we would have received had no tax  
23 been taken off by the employer. In Canada we do not  
24 require grossing up on dividends received since the  
25 corporate tax is legally a tax on the corporation and  
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28 82. The reason for this tedious and complicated  
29 recitation is to point out that in our method of giving  
30 relief from double taxation up to 20% we have gone about



point to wipe out duplication. In the British system, on the other hand, the individual income tax is irreducible and relief is given in respect to the tax paid in by the corporation. Accordingly, in the U.K. if the standard rate paid in upstairs by the corporation on behalf of the shareholders is higher than the shareholders' personal income tax on that dividend income, he can claim a cash refund. Canada side-stepped the almost impossible administrative problem of refunding corporate tax to shareholders (where the upstairs rate exceeds the downstairs rate applying to shareholders) by giving relief in respect of the duplication caused by the downstairs tax rather than that caused by the

81. The U.K. tax paid by corporations is in principle merely deduction of standard income tax at the source just as we have deduction at the source from wages and salaries. Likewise in the U.K. the shareholder has to gross up his dividends just as we have to gross up wages and salaries and take into income for tax purposes what we would have received had no tax been taken off by the employer. In Canada we do not require grossing up on dividends received since the corporate tax is legally a tax on the corporation and not on the shareholder. We take into income only the actual cash dividend received.

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1 as far as we can go without giving to the upper bracket  
2 people a relief from double tax greater than they in  
3 fact suffer (assuming the incidence of the corporate  
4 tax is on them). The explanation for this perhaps un-  
5 suspected result lies in the fact that in not grossing  
6 up the shareholder never has to take into income to be  
7 taxed at say, an 80% rate, the piece of income which  
8 he never receives because it is passed across to the  
9 Government upstairs in payment of tax on the whole  
10 profit of the corporation.

11 83. It was mentioned above that the increase from  
12 10% to 20% in the tax credit was not presented to  
13 Parliament on grounds of removing the double taxation.  
14 There is no reason, therefore, why the credit might  
15 not be moved up beyond the present level purely as an  
16 incentive measure quite unrelated to any question of  
17 double tax. In the light of all the circumstances in  
18 Canada it is suggested here that a further upward move,  
19 say by 10 percentage points in the tax credit, would be  
20 amply justified.

21 Interest as a Deduction in Computing Profits for Tax.

22 84. Fairly closely related to the question of  
23 broadening share ownership in Canada and generally  
24 improving the market for equities is the question of  
25 the assumed inducement in corporate financing to issue  
26 debt rather than equities because interest on debt is  
27 allowed as a deduction in computing profits for tax  
28 purposes while dividends, of course, are not. Sometimes  
29 this point is raised in the form of a question. It is  
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1 stated that since the capital used in a business, whether  
2 equity or debt, is homogeneous and all of it produces  
3 the same profit return why should capital raised by  
4 fixed obligations be treated differently than share  
5 capital in calculating taxable profit? In brief, why  
6 should interest be allowed as a deduction?

7 85. Of course the complete and simple answer to  
8 this question is that the corporate tax is a tax on the  
9 profits of a corporation. It would be just as logical  
10 to ask why wages and salaries are allowed as a cost or  
11 why give capital cost allowances. In other words why  
12 not have a tax on gross receipts, a tax on value added  
13 or a tax on gross revenue rather than a tax on profits  
14 of the corporation. The corporate tax is a tax on the  
15 revenue remaining in the hands of the corporation after  
16 it has deducted all costs incurred in earning the  
17 revenue. Interest on borrowed money is a cost. There-  
18 fore it is allowed as a deduction.

19 86. Perhaps the question should be whether as a  
20 matter of policy it would not be better to disallow  
21 interest as a cost and reduce the corporate rate to the  
22 extent allowed by the additional tax revenue produced  
23 by the disallowance of interest. Annual interest  
24 charges (bond, mortgage, bank and other) against  
25 corporate profits of corporations in Canada are of the  
26 order of \$600 million. At an average effective corpo-  
27 rate rate for large and small corporations of 45%  
28 (Federal and Provincial combined), the disallowances  
29 would yield about \$270 million which would permit a  
30 reduction of say, 9 percentage points in the average





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Of course the complete and simple answer to this question is that the corporate tax is a tax on the profits of a corporation. It would be just as logical to ask why wages and salaries are allowed as a cost or why give capital cost allowances. In other words why not have a tax on gross receipts, a tax on value added or a tax on gross revenue rather than a tax on profits of the corporation. The corporate tax is a tax on the revenue remaining in the hands of the corporation after it has deducted all costs incurred in earning the revenue. Interest on borrowed money is a cost. Therefore it is allowed as a deduction.

Perhaps the question should be whether as a matter of policy it would not be better to disallow interest as a cost and reduce the corporate rate to the extent allowed by the additional tax revenue produced by the disallowance of interest. Annual interest charges (bond, mortgage, bank and other) against corporate profits of corporations in Canada are of the order of \$600 million. At an average effective corporate rate for large and small corporations of 45% would yield about \$270 million which would permit a reduction of say, 9 percentage points in the average



1 corporate rate.

2 87. It is assumed that this question of dis-  
3 allowing interest as a deduction is usually raised by  
4 those who believe that the present situation leads to  
5 distortion in the capital structures of companies, that  
6 it induces them into dangerous equity-debt ratios in  
7 their financing and that this is bad. It is suggested  
8 here that the so-called tax factor as a determinant in  
9 the set-up of most companies is greatly exaggerated.  
10 Surely if the gross rate of profit (before taxes) on  
11 total capital employed is above the borrowing rate for  
12 the corporation (and it usually should be) it will  
13 always be to its advantage to borrow as far as it safely  
14 can - quite apart from the question of tax calculations.  
15 After all there is such a thing as trading on equity  
16 or getting as much leverage as is safely possible on  
17 an equity position.

18 88. There may very well be situations where the  
19 interest deduction factor will swing a close decision  
20 between the issue of preferred stock vs. bonds but it  
21 would be a mistake to attach too much importance to  
22 this particular situation in assessing the overall  
23 picture.

24 89. This general statement about the inherent  
25 advantage to shareholders of a prudent degree of debt  
26 financing by their corporation of course needs a multi-  
27 tude of qualifications. Its reasonableness in any  
28 particular situation will depend on many things. It  
29 assumes that the securities of the corporation are  
30 widely held, that the common shareholders and bond

87. It is assumed that this question of dis-

allowing interest as a deduction is usually raised by those who believe that the present situation leads to distortion in the capital structures of companies, that it induces them into dangerous equity-debt ratios in their financing and that this is bad. It is suggested here that the so-called tax factor as a determinant in the set-up of most companies is greatly exaggerated. Surely if the gross rate of profit (before taxes) on total capital employed is above the borrowing rate for the corporation (and it usually should be) it will

always be to its advantage to borrow as far as it safely can - quite apart from the question of tax calculations. After all there is such a thing as loading on equity or getting as much leverage as is safely possible on an equity position.

88. There may very well be situations where the interest deduction factor will swing a close decision between the issue of preferred stock vs. bonds but it would be a mistake to attach too much importance to this particular situation in assessing the overall picture.

89. This general statement about the inherent advantage to shareholders of a prudent degree of debt financing by their corporation of course needs a number of qualifications. Its reasonableness in any particular situation will depend on many things. It assumes that the securities of the corporation are widely held, that the common shareholders and bond





holders are numerous and not identical persons. For example, it might be assumed that a small private company would almost automatically be financed almost entirely by bonds to secure the maximum interest deduction since if the controlling shareholder owned all the bonds he would never put his own company into receivership if at any time it could not promptly meet its paper obligations to himself. However, if the chief shareholder were in a high personal tax bracket he might not wish to be compelled to take the interest into income (as under the circumstances he would have to do) but would prefer to leave these earnings upstairs in the company to accumulate. Ordinarily he could draw out what he needed in the form of salary or else declare himself a dividend for whatever cash he needed and, incidentally, get a 20% dividend credit by having the earnings come out via this route. But again the net tax benefits may depend on whether and by how much the annual profits in his company exceed \$35,000, the point at which the high corporate rate commences.

90. The financial structures of all wholly-owned subsidiaries (whether foreign-owned or Canadian-owned) will not be influenced at all by the interest deduction factor. In this situation, the tax saving in the subsidiary through charging interest payable to the parent is cancelled out because the parent is taxable on interest received but not on dividends received if the parent is a Canadian company. In the case of a subsidiary wholly-owned by a U.S. parent it would be to its disadvantage to be financed by debt if the U.S.



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1 tax rate were above the Canadian rate, which it usually  
2 has been in the past. Furthermore, the U.S. parent very  
3 frequently wants to plough back all earnings in Canada  
4 and in this case debt financing would be inappropriate.  
5 Thus, apart from the argument that over quite a wide  
6 range of companies, it is not the tax factor but other  
7 shareholder advantages that are responsible for debt  
8 financing, there is, in addition, quite a broad area  
9 where any assumed tax advantage is neutralized by dis-  
10 advantages in other directions.

11 91. Perhaps one of the greatest objections to a  
12 policy of disallowing interest as a deduction is the  
13 unfairness it would inflict on small business men trying  
14 to build up a business with inadequate capital of their  
15 own and who have to finance by debt - mortgage, bond,  
16 bank or otherwise. One immediately thinks, for example,  
17 of the growing number of customers of the Industrial  
18 Development Bank as typical of the group who would be  
19 adversely affected by interest disallowance policy.

20 The small business man with adequate capital resource  
21 of his own would have a distinct advantage over him who  
22 had to borrow to finance his business. Not good.

23 92. Always in tax policy matters changes from the  
24 status quo which in themselves might be good have to  
25 be discarded because of the disruptions, disturbances  
26 and the upsetting of legitimate expectations caused by  
27 the change-over. The disallowance of interest, even  
28 if it were good in principle, would probably, as a  
29 policy, founder on this rock. It is doubtful if any  
30 political government would be willing to walk into the





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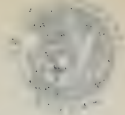
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1     uncertainties involved in such a measure. It could,  
2     of course, be worked into gradually, say one-fifth  
3     of the change-over in each of five years. But even so,  
4     the adjustments in the business world would be bound to  
5     be pretty dramatic. Assuming the disallowance would give  
6     revenue to allow for a 20% cut in the corporate rate,  
7     then all corporations with no debt would have their  
8     taxes reduced by this degree. Companies with a high  
9     debt ratio on the other hand would be severely penalized.  
10    The stock market would at once react, erratically of  
11    source, to these altered prospects.

12    93.         Just for example, the tax liability of Bell  
13    Telephone (held by so many widows and orphans) would be  
14    substantially increased. Many shareholders would panic  
15    and dispose of their shares not knowing of the  
16    probability that the Board of Transport Commissioners  
17    would later get around to giving rate increases suf-  
18    ficient to offset the higher tax. This in turn would  
19    increase the telephone bills of the legion of Bell's  
20    customers and they in turn would have something to say  
21    to the Government about this.

22    94.         It is not the purpose in the foregoing para-  
23    graphs to give too much emphasis to the purely political  
24    arguments against the policy but rather to indicate  
25    briefly the range of purely fortuitous gains and losses  
26    to shareholders and customers in the community through  
27    such a far-reaching change in tax policy. Fortuitous  
28    gains and undeserved losses of this kind in the com-  
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1 disallowance of interest as an expense to justify the  
2 disruption it would cause. This memorandum bluntly states  
3 that none have been put forward so far that would come  
4 anywhere near giving warrant for the policy. Not that  
5 it is relevant to the argument but so far as is known  
6 here, no other country has ever followed a policy of  
7 disallowing interest as a deduction in computing profits  
8 for tax purposes.

9 Taxation of Capital Gains

10 95. The two countries with which Canada is most  
11 closely associated both tax capital gains. In the U.S.  
12 this has been the practice from the early days of income  
13 tax. The U.K. has ventured into this troublesome field  
14 only recently and only in a limited way. In view of the  
15 potential effects of this kind of taxation on capital  
16 accumulation and the operation of the capital market  
17 opinions regarding it might be appropriate in this  
18 memorandum. Following is some analysis of various  
19 points to consider in assessing the expediency of a tax  
20 on capital gains in Canada.

21 96. We do not at present and never have taxed  
22 capital gains in Canada. The Courts have seen to it  
23 that our Income Tax Acts have taxed income only (in  
24 their opinion at least, which is law). Accordingly,  
25 this is a safe statement for a layman to make. However,  
26 in recent years, there has been a considerable volume  
27 of assertions that in fact the administration has  
28 pushed assessments pretty deeply into the field of  
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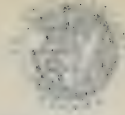
1 97. What in fact has happened is that the  
2 Department, after years of turning a blind eye on  
3 certain transactions started issuing assessments against  
4 people who had not been reporting certain gains as in-  
5 come. Mainly the Department concentrated on real  
6 estate, second mortgages and various miscellaneous  
7 deals. They have rather meticulously avoided the  
8 general field of dealings in securities (except some  
9 promoter type in-and-outers) which is next to impossible  
10 to sort out satisfactorily under an income tax law.  
11 In this, the Department has followed pretty closely  
12 the U.K. pattern of income tax administration and our  
13 Courts have leaned heavily on U.K. jurisprudence and  
14 judicial reasoning.

15 98. As an approach to the question of the ex-  
16 pediency of a capital gains tax for Canada, one might  
17 take a critical look at the usual economic arguments  
18 advanced against such a tax.

19 99. We have all heard many times in discussion  
20 of a tax on capital gains, the so-called argument that  
21 in a new, growing, immature, capital-importing and  
22 underdeveloped country, such as Canada, struggling for  
23 the rapid development of our boundless natural resources  
24 with which Divine Providence has so richly endowed us,  
25 a tax on capital gains would be a very bad thing. This  
26 sort of stuffy assertion rarely if ever carries with  
27 it any supporting argument. By itself, it sounds so  
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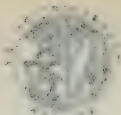
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1 the argument would be that because a person would be  
2 liable for a tax upon the excess of the selling price  
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4 he would be disinclined to enter into the transaction;  
5 that he would be discouraged from undertaking various  
6 business enterprises and ventures, all of which would  
7 have a stultifying effect on the business world; that  
8 enterprises which should be undertaken would be foregone  
9 because of the possibility that at some future time  
10 there might be a tax on gains from the sale of some or  
11 all assets. This does not sound very convincing.  
12 Surely for most people embarking on a serious business  
13 project the least of their troubles would be the  
14 question of tax on the eventual sale of business  
15 assets at an advantage some time in the future.

16 101. With a tax on capital gains on the books just  
17 as many fishermen would build or buy boats or ships and  
18 go down to the sea in them; just as many farmers would  
19 buy farms, machinery and equipment, put up buildings  
20 and go on labouring from dawn to dark. Who will suggest  
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1 selling out again shortly.

2 102. As for the natural resources industries, it  
3 is not easy to believe that opportunities for profitable  
4 development would be passed up because of a capital gains  
5 tax. Who would say that the Knobb Lakes, Wabushes,  
6 Kitemat-Kemanos, Thompsons, Yellowknives, Blind Rivers,  
7 the Leducs, Redwaters, Pembinas would not have appeared,  
8 and just as soon, if there had been a tax on capital  
9 gains in Canada?

10 103. In considering a tax on capital gains most  
11 of us, it seems, are inclined to think in terms of its  
12 effects on individuals qua individuals. One rarely  
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14 the greater volume of business that keeps our country  
15 going today is done by corporations. Decisions will,  
16 of course, be made by individual officers of the  
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23 property.

24 104. To this point an attempt has been made to  
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1 same. The heavens would not fall. But, of course,  
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4 105. It might be held that the above analysis,  
5 which has looked broadly at the business world as a  
6 going concern and has concluded that a capital gains  
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16 have scared away a significant volume of capital that  
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19 106. It is perhaps impossible to attempt an exact  
20 generalization about the over-all financing situation  
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22 Broadly, however, it might be said that there are two  
23 main sources of venture capital that might be looked at  
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107. Speaking as one quite out of his depth in these matters, one might still venture the opinion that



1 a moderate tax on capital gains, say, 10%-20%, or even  
2 25%, would not have a very significant effect on the  
3 dollar volume of funds flowing into stock markets in  
4 Canada today if losses were allowed. In the first  
5 place there is the large, solid, supporting group whose  
6 main object in buying securities is to secure a  
7 relatively constant flow of income from stocks with the  
8 intent to hold, who should not be deterred from  
9 continuing to invest because of a tax on subsequent  
10 eventual selling out. They could, of course, be ex-  
11 pected to protest bitterly and predict the ruination of  
12 the country, but one can doubt if they would cease in-  
13 vesting the same volume of funds in equities.

14 108. Another very large group supporting the  
15 market is made up of investment trusts, pension funds,  
16 life insurance companies, universities and charitable  
17 institutions generally. They would all be unaffected  
18 by a tax on capital gains. It is not known what pro-  
19 portion of the market for equities is represented by  
20 the groups just mentioned, but we all know that it must  
21 be very substantial indeed.

22 109. One cannot be too sure how a capital gains  
23 tax would affect that very numerous, hardy and hopeful  
24 perennial group of souls who, operating a bit breath-  
25 lessly on tips and rumours, venture mightily into the  
26 market with a few hundred dollars or more, usually in  
27 mines and oils where really startling and exciting  
28 things can happen any time. One can guess, however,  
29 that most of them would be extremely reluctant to forego  
30 their noon visits to brokers' offices, the pleasure of







1 telling their friends how well they've done in the  
2 market, and the exhilaration of being a knowing sort of  
3 capitalist fellow, full of wisdom about this and that  
4 in the business world. Then too, one should always  
5 remember that if capital gains are taxed, capital losses  
6 may be deducted. This fact, one can be sure, would  
7 free most of the amateur in-and-outers from any year-  
8 end liability for capital gains tax. Finally, regard-  
9 less of how this group would react, it is unlikely that  
10 these small operators contribute very greatly to the  
11 total of funds left in the capital market for economic  
12 development of the country.

13 110. As for the substantial knowledgeable  
14 operators who are in and out of the market with con-  
15 siderable regularity it is not to be expected that they  
16 would give up because of a moderate tax. One does not  
17 hear of a scarcity of this kind of venturesome money  
18 in the U.S.

19 111. The significance of the second broad source  
20 of outside venture capital, the moneyed, well-to-do  
21 individuals, is harder to assess. These fortunate  
22 souls may take the initiative in seeking out op-  
23 portunities for placing fairly substantial blocks of  
24 funds or, perhaps more frequently, they are approached  
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27 characters may be willing to let big money in, give  
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1 their energy, ingenuity, venturesomeness and general  
2 pushiness would not otherwise take place in the busi-  
3 ness life of the community. Some person always has to  
4 have ideas and take the initiative to start things  
5 moving. They are a valuable asset in any country.

6 112. Granting, however, that as a total the funds  
7 placed in industry by moneyed individuals in blocks  
8 through direct contact with persons taking the initiative  
9 in a venture is quite substantial, it does seem that  
10 we have to look a little more closely to see whether  
11 generally their idea is mainly to get in and out again  
12 fairly soon and make a quick capital gain, or whether  
13 they plan to hold on somewhat indefinitely to reap the  
14 benefits of the venture through a flow of income with  
15 growth prospects over a 5, 10 or 15 year period. It  
16 seems reasonable to assume that the relatively big  
17 money fits into the latter group, that is, that it tends  
18 to stay in for eventual results, and that the in-and-  
19 outer, the promoter type of restless money, while  
20 important in its way, is not so significant in the  
21 broad economic development of a country.

22 113. If this view is somewhere near right, the  
23 fair conclusion to be drawn is that the big, important  
24 flow of venture money from individuals would not be  
25 significantly affected by a tax on capital gains. The  
26 other, the quick, year-or-two, in-and-out money would  
27 probably be deterred to some extent by a capital gains  
28 tax - the extent being determined mainly by the level  
29 of the tax. Probably 25% would not kill much.

30 114. Again, in considering the part played in our





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have ideas and take the initiative to start things  
moving. They are a valuable asset in any country.  
112. Granting, however, that as a total the funds  
placed in industry by moved individuals do make  
through direct contact with persons taking the initiative  
in a venture is quite substantial, it does seem that  
we have to look a little more closely to see whether  
generally their idea is mainly to get in and out again  
fairly soon and make a quick capital gain, or whether  
they plan to hold on somewhat indefinitely to reap the  
benefits of the venture through a flow of income when  
growth prospects over a 5, 10 or 15 year period. It  
seems reasonable to assume that the relatively big  
money fits into the latter group, that is, that it tends  
to stay in for eventual results, and that the in- and-  
outer, the promoter type of restless money, while  
important in the way, is not so significant in the  
broad economic development of a country.  
113. If this view is somewhere near right, the  
fair conclusion to be drawn is that the big, important  
flow of venture money from individuals would not be  
significantly affected by a tax on capital gains. The  
other, the quick, year-or-two, in-and-out money would  
probably be deterred to some extent by a capital gains  
tax - the extent being determined mainly by the level  
of the tax. Probably 25% would not kill much.  
114. Again, in considering the part played in our



1 economy by individuals with money and with initiative  
2 - the urge to put ideas into bricks and mortar - we  
3 must constantly come back to the fact that in our modern  
4 economy it is mainly big corporations with money, vision  
5 and know-how that are responsible for the main course  
6 of economic development, new capital investment, and,  
7 generally, for making the economy march.

8 115. To be impressed by this fact, one merely has  
9 to look over the giants and even lesser operating units  
10 in the fields of manufacturing, transport, public  
11 utilities, marketing, and so on. Particularly, is this  
12 evident in the development of natural resources. The  
13 mining industry today, for example, is dominated by  
14 empires. They do their own exploring, developing,  
15 and constantly are on the look-out for likely new  
16 significant ore bodies. In the oil and gas industries,  
17 the big money flow is through a handful of large, in-  
18 tegrated companies with an international flavour. Pulp  
19 and paper companies have to be large in order to operate  
20 at all. This is no place for the individual with a few  
21 hundreds of thousands of dollars. Old-timers and in-  
22 dependents in the natural resources fields may deplore  
23 these facts, but they cannot be disregarded in summing  
24 up the situation. The point of all this is that the  
25 investment activities of these corporations would be  
26 completely unaffected by a capital gains tax. In-  
27 cidentally, mention might be made here in passing of  
28 the extent to which new capital investment by corpor-  
29 ations is financed out of retained earnings, and, ac-  
30 cordingly, is not dependent in any way upon outside



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1 investor decisions for this supply of capital.

2 116. There are quite a number of people in this  
3 country who claim they are in favour of a capital gains  
4 tax and offer an inverted sort of argument related to  
5 what is suggested above. Their position is somewhat  
6 as follows: Canada professes not to tax capital gains  
7 today. However, the uncertainty in the law through lack  
8 of clarification in some directions is such that people  
9 are deterred from proceeding with important business  
10 transactions because of the fear that they will be held  
11 by the Courts to have entered into an "undertaking" or  
12 "an adventure or a concern in the nature of trade".  
13 If this horrible fact can be proven against them, then  
14 the alleged capital gains will in law be profits from  
15 a business and taxable in the hands of an individual  
16 as regular income at full graduated rates, possibly as  
17 high as 60% or 70% or more. Accordingly, it is argued,  
18 we should have a capital gains tax under which this  
19 kind of gains would be taxed at the relatively low  
20 capital gains rate, which would not, it is held, deter  
21 the person from going ahead with an undertaking of con-  
22 siderable importance to the community. He would have  
23 certainly.

24 117. This proposal, however, does not really touch  
25 the problem. The mere introduction of a tax on capital  
26 gains as our present law sees them would not at all  
27 cure the situation just described. The gains just  
28 referred to, which, if held by the Courts to be income,  
29 would still be income taxable at graduated rates even  
30 after the introduction of a capital gains tax, unless



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1 simultaneously the present definition of income were  
2 changed. The transactions in question could only be  
3 freed from graduated tax by re-defining what constitutes  
4 carrying on business. There would still remain the  
5 problem of drawing a line in this very awkward field  
6 where carrying on business is essentially a matter of  
7 degree and is not absolute. The problem of uncertainty  
8 would continue to exist, even under the most skilfully  
9 worded amendment directed towards a less inclusive  
10 definition of income from a business.

11 118. Those who suggest the general capital gains  
12 tax on the grounds mentioned above - in effect to im-  
13 prove the capital market - are fumbling pretty badly.  
14 There is obviously no point whatsoever in imposing a  
15 capital gains tax across the board - the U.S. type -  
16 to cure the marginal problem they are concerned with.  
17 This is simply asking for more trouble. What only is  
18 needed are words or phrases which in a negative way  
19 would declare that doing certain things does not consti-  
20 tute carrying on business and giving rise to income.

21 119. This may sound like a very fruitful approach  
22 but it has been tried and found to be pretty difficult.  
23 Section 83(3) of the Income Tax Act does something  
24 along this line to free from tax the gains from grub-  
25 staking mining prospectors. Probably no one is very  
26 happy about this provision. It has given rise to a  
27 breed known as Bay Street prospectors.

28 120. It is impossible to know how many of these  
29 individual promoter type transactions are inhibited by  
30 the fear of graduated income tax or how important they





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1 are. These promoter fellows, of course, can be an ex-  
2 tremely valuable asset in the economic community. It  
3 would be too bad if many were restrained through tax.  
4 However, it almost goes without saying that the blame  
5 placed on the tax in all back-room discussions on this  
6 subject - which is where most of them take place - will  
7 be greatly exaggerated. It could be just a relatively  
8 small fringe problem, deplorable but not too fundamental.  
9 121. There are two more points about a capital  
10 gains tax that might be made in this section dealing  
11 with economic arguments pro and con. The first has to  
12 do with the amount of capital that, as it were, would  
13 be taxed away from the capital market by such a levy.  
14 There has been some talk recently from the political  
15 Left that a capital gains tax could be used to finance  
16 more social security. This is a pretty extravagant  
17 piece of election patter. Possibly a capital gains tax  
18 in Canada would produce \$80-\$100 million a year. It  
19 would not be a big revenue producer. It is not im-  
20 portant even in the United States revenue system. As  
21 a matter of fact, in the United States it has been said  
22 that the capital gains rate is used as much for giving  
23 relief from higher normal rates as it has for imposing  
24 extra tax.

25 122. In good years in Canada the total amount of  
26 capital invested is something of the order of \$9 billion.  
27 Thus an amount of about 1% of this total might be taxed  
28 away. Of the amount taxed away let us arbitrarily say  
29 that perhaps one-half might be from transactions in  
30 property in personal use rather than from property used



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1 in business. This would mean then that the capital  
2 gains tax had depleted capital otherwise destined for  
3 economic or productive growth by something of the order  
4 of one-half of one percent. This is not a figure  
5 large enough to cause alarm in anybody's heart. It can  
6 be agreed then that a capital gains tax would not cut  
7 deeply into the national capital account.

8 123. The second point which might be made against  
9 those who fear drastic economic effects from a capital  
10 gains tax is to invite them to look south of the border  
11 where such a tax has been operating for many decades  
12 - God help them. Economically, they seem to have done  
13 very well in spite of it. The non sequiturs in this  
14 as argument are to be ignored. The fact is merely  
15 mentioned in passing.

16 124. From the above rather sketchy analysis it  
17 is fair to conclude that the usual claims about the  
18 dire effects on the business community of taxing  
19 capital gains are quite immoderate to say the least.  
20 They are another example of the sort of easy exag-  
21 geration that almost automatically flows from emotional  
22 expressions on tax matters. The main objections to  
23 taxing capital gains are not to be found in the alleged  
24 disastrous effects on the capital market but elsewhere.  
25 These will now be explored.

26 125. First of all, no government in Canada should  
27 consider for a minute a tax on capital gains measured  
28 in dollars until the value of these dollars has been  
29 firmly stabilized, that is until we can be assured that  
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1 picture. With inflation, a tax on so-called capital  
2 gains becomes a very unfair and arbitrary tax on capital  
3 itself for those compelled at various times to realize  
4 on the accrued increase in the dollar value of their  
5 property. The Canadian dollar is worth less than half  
6 of what it was in 1939. For purposes of illustrating  
7 the point being made, let us assume that a person  
8 bought a house in 1939 for \$10,000. Today if the house  
9 has moved up in value corresponding to the fall in the  
10 value of the dollar, it would be worth something over  
11 \$20,000. In selling it for that upon having to move  
12 to take a job elsewhere, one would be liable for tax  
13 on \$10,000 plus capital gain and would, accordingly,  
14 find himself short of the funds needed to purchase in  
15 1962 the same sort of house he just parted with. Of  
16 course, this sort of situation can be alleviated by  
17 making exceptions as they do in the U.S. if the tax-  
18 payer re-purchases a house within twelve months or has  
19 one rebuilt within eighteen months. In the U.K. they  
20 exempt sales of houses occupied by the taxpayer. But  
21 this is where complexity begins to take over. The un-  
22 fairness of a capital gains tax where inflation operates  
23 cannot possibly be cured by creating exceptions. The  
24 law would completely bog down in utter complexity, ad-  
25 ministrative impossibility and floods of litigation.

26 126. The main case against a capital gains tax  
27 is its complexity. It has been held that there is more  
28 litigation in the U.S. in this relatively narrow field  
29 than there is in all the remaining sections of the law  
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1 revenue. If the government needs an additional \$100  
2 million of revenue (and it badly does) there are many  
3 better and fairer ways of getting it than imposing a  
4 general tax on capital gains. A capital gains tax  
5 imposed say, in 1962, to apply then and thereafter  
6 would require everybody to establish somehow, somewhere,  
7 the value of all his property piece in that year so  
8 that 10, 15, 20 or possibly 50 years hence he could  
9 declare and prove that upon sale of the property his  
10 capital gain was exactly so many dollars, no more, no  
11 less after, of course, having kept track of all such  
12 things as taxes, depreciation, maintenance, repairs and  
13 so on for all the intervening years. Surely the more  
14 statement of these requirements is sufficient to make  
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127. The answer given by U.S. experts that in their country it works is not good enough. It is well known that the U.S. tax law and its administration calls for more complex artificial and unreasonable burdens of tax compliance than any government in Canada would ever dare to try to impose or inflict on our long-suffering public. The insidious part of it is that in principle the capital gains tax is very simple but, in fact, the complexities in it are quite appalling.

128. It can be said with some truth that a tax on capital gains is merely an estate tax in a hurry. It taxes capital gains when they are realized instead of waiting to tax the accumulation at the end of the road to pick up revenue through a tax on the total estate. Furthermore, looked at analytically, it is quite anomalous to build a tax on capital gains into and make of it an integral part of a graduated tax on income.

129. Income tax is a tax on a flow of income. Being a flow it has to be measured by reference to a period of time. We use an arbitrary twelve month period. Personal exemptions are then related to the length of this accounting period. If the accounting period were twice as long the personal exemption would have to be twice as large. The graduated rate structure is tailored to fit the length of the accounting period, that is, to the amount of income flow that is lumped up for tax purposes. The present rate structure applied against twelve months of income hurts badly enough but applied to two years of income



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1 the result would be simply excruciating. It is the  
2 height of absurdity to try to inject capital gains  
3 logically into this income tax framework when the gains  
4 realized in any year may have been accruing for only a  
5 few months, one year, five years, twenty years or  
6 perhaps even forty years. It just does not make sense.  
7 So the bright boys have to start tinkering. A line  
8 is drawn between short-term and long-term gains.  
9 "Long" used here may be two years or forty years -  
10 both periods are long.

11 130. A graduated rate structure applied to these  
12 two long-term lumps of gain would be unfair to the  
13 taxpayer and so he may be given a choice between a  
14 flat rate tax or taking only one-half of the gain  
15 into income. And so it goes, trying to fit square  
16 pegs into round holes. If for any reason not yet on  
17 the horizon in Canada capital gains simply had to be  
18 taxed, the best way would be to put on a flat rate  
19 excise tax and make no pretense whatsoever at assoc-  
20 iating it with the income tax structure. One hastens  
21 to add, however, that all the complexities of  
22 valuation and establishing a base point would still  
23 be encountered under an excise tax on capital gains.

24 131. Demands for a capital gains tax are usually  
25 heard from the political Left. In our Parliament,  
26 members of the old CCF party frequently have urged the  
27 Minister of Finance to introduce one. Usually there  
28 has not been much of a head of steam behind these  
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1 designed to give a systematic reply to these proposals.  
2 Essentially, the question is whether in a tax system  
3 which must always be held to be fair and reasonable,  
4 recognizing the principle of taxation according to  
5 ability to pay, it is fair to allow capital gains to  
6 go untaxed at the time of realization.

7 132. Trying to pass judgment on the fairness or  
8 reasonableness of any proposed course of action in  
9 taxing is always a pretty frustrating sort of business  
10 and it is particularly fruitless to try to pass  
11 judgment on the question of the fairness of a particular  
12 kind of tax taken by itself without looking at all the  
13 other kinds of taxes, Federal, Provincial and Municipal.  
14 That is, we should look at the total complex of in-  
15 payments to governments in Canada and at the same time  
16 have regard to the annual flow and distribution of  
17 out-payments and services from the government in this  
18 day of the Welfare State. A few facts and opinions  
19 on this question will follow.

20 133. In the first place, it can be stated as a  
21 general proposition that capital gains if unspent and  
22 not subsequently lost are taxed under the estate tax  
23 on the taxpayer's death. A Minister of Finance once  
24 mentioned this as an important reason for the entry  
25 of the Federal Government into the death duty field !  
26 Some people, of course, - to what extent is not known  
27 - spend their capital gains in most un-bourgeois-like  
28 fashion instead of saving them and where this happens  
29 capital gains will not be taxed on their death. If,  
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1 accumulate, they will have run into Federal sales tax  
2 of 11% on much of this expenditure as well as  
3 provincial sales taxes at varying levels in most  
4 directions where the money was spent. Miscellaneous  
5 taxes of this sort can add up to quite significant  
6 amounts and they are avoided by people who save their  
7 gains for their old age or their descendants. It might  
8 be mentioned in passing that in the United States there  
9 is no general sales tax at the federal level on  
10 consumer goods expenditure corresponding to that in  
11 Canada.

12 134. Even assuming that the money made on capital  
13 gains never bore any tax whatsoever, it would still  
14 not necessarily mean that there was any unfairness  
15 in the tax system. If by far the great majority of  
16 people own some property and therefore have occasion  
17 to make some capital gains now and then there would  
18 be no unfairness in the system through not taxing  
19 anybody on this sort of gain. A good example of this  
20 principle is seen in the exemption from tax of all  
21 the earnings on savings accumulating in the life  
22 insurance field. There are probably about six  
23 million life insurance policies in force in Canada,  
24 that is, practically everybody has one and there is,  
25 accordingly, no real unfairness in allowing income  
26 accumulations in these directions to go untaxed.

27 135. Very few people in Canada today can be  
28 said to be living below the poverty line or are  
29 completely propertyless. One has merely to stroll  
30 through the so-called slum areas of large cities and



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...ulate, they will have run into Federal sales tax  
 of 1% on much of this expenditure as well as  
 provincial sales taxes at varying levels in most  
 directions where the money was spent. Miscellaneous  
 taxes of this sort can add up to quite significant  
 amounts and they are avoided by people who have their  
 gains for their old age or their descendants. It might  
 be mentioned in passing that in the United States there  
 is no general sales tax on the federal level and  
 consumer goods expenditure corresponding to that in

194. Even assuming that the money made on capital  
 gains never bore any tax whatever, it would still  
 not necessarily mean that there was any advantage  
 in the tax system. It is by far the great majority of  
 people own some property and therefore have occasion  
 to make some capital gains now and then there would  
 be no advantage in the system through not taxing  
 anybody on this sort of gain. A good example of this  
 principle is seen in the exemption from tax of all  
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 million life insurance policies in force in Canada,  
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 accordingly, no real advantage in allowing income  
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 Very few people in Canada today can be  
 said to be living below the poverty line or are  
 completely propertyless. One has merely to stroll  
 through the so-called slum areas of large cities and



1 observe the forest of television aerials outlined  
2 against the sky or to observe the parking space needed  
3 outside the modern industrial plants to accommodate  
4 workers' automobiles to be thoroughly convinced that  
5 our society is not one which divides itself into the  
6 haves and the have-nots. Government assistance in the  
7 field of housing is fast making property owners of all  
8 who in the terminology of some people would be called  
9 the proletariat.

10 136. The recent introduction of a limited capital  
11 gains tax in the U.K. is quite openly a political  
12 manoeuvre by the Conservative Government. The  
13 Chancellor of the Exchequer admitted that it had  
14 little, if any revenue implications, that it was  
15 mainly for what he regarded would mean greater equity  
16 in their tax system. Frankly, it was a piece in the  
17 Government's attempt to offset the unpopularity of  
18 pay-pause policy. In the U.K. they have to pay far  
19 more attention to what might be called the class  
20 warfare angles in tax policy. The impression had got  
21 around in the U.K. that quite a large number of  
22 people were living well off of stock market gains  
23 (one wonders what would be said now in the light of the  
24 losses taken by these people in recent months). Also  
25 very profitable transactions on a wide scale in  
26 real estate had been escaping tax through the  
27 incorporation of land companies and the sale of shares  
28 in them in a block to the purchaser (Canada has been  
29 far more effective in dealing with real estate  
30 transactions than they have been in the U.K.). So





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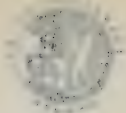
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1 to show that they were on the right side with the  
2 masses, the U.K. Government blundered into this field  
3 with pages and pages of complex illogical law.

4 137. It would not be sensible to regard the  
5 recent U.K. entry into this field as a basis for  
6 arguing similar policy for Canada. It is fair to  
7 say that the U.S. practically stumbled into taxing  
8 capital gains. There is no special law in that  
9 country imposing this kind of tax. It came about  
10 entirely through an interpretation of the Courts of  
11 a definition of income almost identical with that  
12 contained in our original income tax Act. Whether  
13 apart from this turn of events, and the tradition  
14 built on it, the U.S. would today decide as a matter  
15 of policy to tax capital gains is hard to say. Many  
16 European countries have a limited form of taxation on  
17 capital gains mainly, however, applying solely to  
18 corporations.

19 138. Essentially the position taken in this  
20 memorandum is that the economic arguments pro and con  
21 are not too significant. The fact is this tax is a  
22 very poor way to raise revenue in that it is too  
23 complex and too troublesome for both the taxpayer  
24 and the government. Furthermore, it does not seem  
25 that over-all fairness in the tax system as a whole  
26 demands it. It was stated above that the personal  
27 income tax at graduated rates, while not seriously  
28 undermining the incentive to save and invest does  
29 cut very drastically into the ability to save and  
30 invest by those who might be expected to supply a



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1 great deal of capital for investment in Canadian  
2 industry. A capital gains tax would similarly cut  
3 into the supply of capital available for re-investment.  
4 It would worsen the already bad situation created by  
5 graduated income tax.

6 Tax Incentives

7 139. It is so much the fashion these days to  
8 advocate tax incentives as the generating force needed  
9 to revitalize the community and restore growth to a  
10 prosperous but uninspired state of affairs in our  
11 business world that a general survey of the tax  
12 structure would seem quite incomplete without comment  
13 on this philosophy.

14 140. In the light of views stated earlier in  
15 this memorandum it cannot be claimed that this topic  
16 has too much direct relevance to the terms of reference  
17 of this Commission. True, a healthy growing economy  
18 in a fair state of equilibrium has less problems in  
19 the field of banking and finance than one in the  
20 doldrums with uncertain prospects. The so-called  
21 psychological factor can be of some importance.  
22 However, it has been suggested earlier in this  
23 memorandum that personal income tax does not, on  
24 balance, lessen very much the urge to work, get ahead  
25 and improve job status; that it does not discourage  
26 saving and investment very much; that the corporate  
27 tax has little more adverse effect on the economy  
28 than would a sales tax (to give the same volume of  
29 revenue) applying to the products and services sold  
30 by corporations. It is submitted, however, that the

last amount disbursed

to revitalize the community and restore growth in a



1 pattern of downward re-distribution of income  
2 generally through all ranges of income effected through  
3 welfare legislation financed by proportional and  
4 graduated taxes, has a very real effect in limiting  
5 the domestic supply of capital available to build up  
6 an acceptable status for an independent national  
7 economy. Nevertheless, it might be useful to the  
8 Commission to have before them a view on the general  
9 importance of this alleged cure-all tax incentive.

10 141. The faith of the general public in  
11 gimmicks is amazing and it verges on the pathetic  
12 in this field of tax policy. It does not follow,  
13 of course, that because the existing tax structure  
14 is not in itself to any extent a positive deterrent  
15 to personal effort, business activity, saving and  
16 investment that certain devices would not have  
17 beneficial net incentive effects. It still could  
18 happen that relief from the standard burden would  
19 induce people to do things they would not otherwise  
20 go ahead with! This is the basic principle of  
21 incentive legislation.

22 142. All in all, we in Canada have been a bit  
23 unlucky in the outcome of tax incentive gadgets in  
24 the past. In 1938-39, we introduced a 10% tax credit  
25 for new capital investment to get things going a little  
26 faster at the end of the bad thirties (the U.S. is  
27 deciding about now to try the same thing). We got it  
28 nicely going when the war came along and made it all  
29 very unnecessary. The cost of that one pretty much  
30 went down the drain. In wartime, we introduced forced





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1 savings to help lick inflation and to build up a  
2 fund for repayment at the end of the war to offset  
3 expected depression. Instead of depression, of course,  
4 we were still fighting inflation and the out-payment  
5 of the forced savings merely aggravated the problem.  
6 143. We offered double depreciation for new  
7 investment in a two year post-war period when, as it  
8 turned out, the overwhelming excess of new investment  
9 was already a major national problem. In the Korean  
10 episode we disallowed normal depreciation for a three  
11 year period on unessential capital expenditure in order  
12 to slow it down. Shortly thereafter, it seemed that  
13 this was not needed so the government relented and  
14 said, in effect, you may now take the writeoff which  
15 we told you you could not have when you made the  
16 investment. This served notice, as it were, that if  
17 in future we try this sort of thing again, you cannot  
18 be sure that we will really do what we said we would.  
19 144. Recently, the Government has dabbled in  
20 this field. In 1961, the provisions which were  
21 introduced to induce industry into depressed areas  
22 and new products were merely gestures with no  
23 significant leverage in them! In 1962, provisions  
24 for tax abatement on profit from increased sales and  
25 the incentive for research expenditure may have some  
26 real substance.  
27 145. The tax abatement on profits from increased  
28 sales in manufacturing and processing should have some  
29 effect in stimulating export trade. If all firms  
30 in an industry try to increase their domestic sales



1910





1 they may not, as a group, add much to total sales or  
2 increased employment in Canada. However, there is  
3 unlimited scope for pushing into the export market for  
4 some products and this type of provision being general  
5 in its application, does not offend against GATT. But  
6 the great obstacle to whole-hearted approval of this  
7 rather typical sort of incentive is its complexity.  
8 In principle, it sounds good and simple. However,  
9 Government officials, tax lawyers and accountants,  
10 generally are frankly appalled at the prospect of  
11 pages and pages of complex and arbitrary law and  
12 regulations that will be necessary to make it work.  
13 It cannot possibly work fairly and there is some doubt  
14 that it can be made to work at all. The scope for  
15 manipulating and juggling is a bit awful.  
16 146. Just for example, a U.S. parent may decide  
17 that it would pay to put some of its own export sales  
18 through its Canadian subsidiary. It could sell to it  
19 and the sale to the foreigner could be made in the  
20 name of the Canadian subsidiary without the goods  
21 ever entering Canada at all for export. This move  
22 could, of course, be very simply blocked by providing  
23 that the goods have to be produced in Canada. Then  
24 the next question is how large must the "Canadian  
25 content" be. Does the law have to get down to a  
26 "value added" in Canada as the legitimate base for  
27 measuring increases. This is just an example of the  
28 sort of thing that will make life difficult and  
29 miserable for Government officials and profitable for  
30 lawyers and accountants when this proposal becomes law.



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1                   The main and very real difficulty in the  
2       scientific research incentive is definition. To  
3       have much leverage, it will have to include the  
4       exploratory and development work in applying a  
5       scientific knowledge to industrial processes, pilot  
6       plant expenditure and so on. Some very difficult  
7       lines will have to be drawn here. For example, pilot  
8       plants at times are kept in operation for regular  
9       industrial production. This attempt to encourage  
10      research is more in the nature of a long-run policy  
11      and cannot have much immediate effect on business and  
12      employment. While it would be good to have more  
13      industrial research done in Canada, it is quite  
14      natural and probably more economic that for subsid-  
15      iaries the research should be carried on by the  
16      parent company abroad. There are many cases now  
17      where there is no charge against Canadian profits for  
18      research carried on by the parent abroad. The benefits  
19      all come free. The same is true for much advertising.  
20      Switching research expenditure from the U.S. to Canada  
21      will not be all gain by any means.

22    148.       As for tax incentives generally the British  
23    form of investment allowances seem to be the best so  
24    far conceived and they have the great advantage of  
25    relative simplicity. They simply allow an additional  
26    write-off for expenditure on depreciable assets, i.e.,  
27    some percentage more than was spent. They can be  
28    given to all taxpayers generally or to selected  
29    industries that need encouraging, such as shipbuilding  
30    for example; or they can be given for particular areas





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1 (such as the Atlantic Provinces). They have far  
2 more leverage than accelerated write-offs of actual  
3 expenditure which, in effect, offers only an interest  
4 free loan of tax money for a few years. This can  
5 help the cash position of the less well fixed  
6 companies but offers little financial benefit to the  
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8 149. For one who has been paid for many years to  
9 produce ideas for the tax system, the almost invariable  
10 result of attempting much refinement in taxing is  
11 disappointment. No one who has had much experience  
12 trying to build useful and workable incentives into  
13 tax law should be very enthusiastic about them. It  
14 seems to be almost inevitable in the case of each  
15 experiment that at some stage he will admit that had  
16 he known in advance the difficulties the measure  
17 would encounter, the unfairnesses it would create and  
18 the unforeseen manipulation it would afford, he would  
19 never have had the courage to propose it.

20 150. Good as some tax incentives may appear to be,  
21 the question always arises - and can never be answered  
22 with certainty - whether it would not have been better  
23 for the economy as a whole if the time and money  
24 (loss of revenue) spent on gimmicks would not have  
25 been better applied to a rate reduction for industry  
26 generally. The view here is that as a general rule  
27 it would.

#### 28 Fiscal Policy

29 151. It is assumed here that one of the major  
30 purposes of this Commission is to assess the effective-



(such as the Atlantic Provinces). They have far more leverage than accelerated write-offs of actual expenditures which, in effect, offers only an interest free loan of tax money for a few years. This can help the cash position of the less well fixed companies but offers little financial benefit to the public.

For one who has been paid for many years to produce ideas for the tax system, the almost inevitable result of attempting much refinement in taxing is disappointment. No one who has had much experience trying to build useful and workable incentives into tax law should be very enthusiastic about them. It seems to be almost inevitable in the case of each experiment that at some stage he will admit that had he known in advance the difficulties the measure would encounter, he would not have proposed it.

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Financial Policy

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ness of Central Banking in Canada, to determine how successful the Bank has been in its attempt "to mitigate by its influence fluctuations in the general level of production, trade, prices and employment" and to recommend any changes that they think might help. There are those, of course, who believe that fiscal policy can be equally, if not more effective than monetary policy in performing these functions which Parliament assigned to the Bank of Canada. This memorandum offers comment on the validity of this claim. Briefly stated in advance it does not agree with the proposition.

152. Over the past few decades, opinion has varied greatly regarding the relative importance of the two instruments for control over the economy, monetary policy and fiscal policy. It is fair to say that during the thirties the main reliance was on monetary policy. There was some disillusionment when it became so obvious that the utmost in easy money policy could not induce recovery, that even a negative rate of interest would not bring on economic activity if other conditions were not favourable. This led to a groping for and the emergence of fiscal policy as the right answer to many things. The experiment with tax credits for new capital expenditure mentioned above represented the beginnings in Canada of a new line of thought. The 1939 and 1940 War budgets revealed a pretty clear philosophy of the importance of taxing in relation to business activity and employment. As the War period developed taxation



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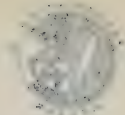
1 was an important and probably fairly effective  
2 supplement to price control in containing inflation.  
3 153. Paralleling this rise in favour of fiscal  
4 policy was the further decline in the prestige of  
5 monetary policy. Central Bank functions during and  
6 after the War were almost completely prostituted and  
7 dedicated to the greater glory of bond salesmen. We  
8 had reached a stage where it was practically an offence  
9 unto decency to let a Government bond fall below par.  
10 Recriminations poured in from all sides when finally  
11 this happened.

12 154. Utter faith in fiscal policy in post-war  
13 years reached heights that now, in retrospect, appear  
14 little short of absurd. National planners with a  
15 gleam in their eye went completely overboard on the  
16 idea. Centralization of power in Ottawa was the  
17 main theme. Federal-Provincial tax agreements were  
18 to be the keystone of the new structure. The Welfare  
19 State was well advanced on the drafting board. It  
20 was to provide for stabilized purchasing power.

21 Shelves of public works were to be built up.  
22 Provincial and Municipal capital expenditure programs  
23 were to be controlled by degrees of cost-sharing by  
24 Ottawa. Economic activity was to be carefully  
25 controlled. Growth was to be assured and continuous,  
26 Excessive booms, depressions and recessions could not  
27 happen again. The golden age was about to dawn.

28 155. The general plan was simple, insidiously so.  
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1 was to give a basic stability to consumer purchasing  
2 power. The poverty reflected in the low level of  
3 retail sales in the early thirties would not be allowed  
4 to happen again. If recession so much as reared its  
5 head, taxes would be cut to increase purchasing power  
6 and recession would recede. If activity got too hectic  
7 with excess demand starting to pull up prices, taxes  
8 would be increased and with lessened demand, the price  
9 rise would fall back into place. Just about like that.  
10 156. It is inappropriate here to try to record all  
11 the various reasons for the decline and fall of this  
12 rather naive faith in fiscal manipulation. It will  
13 suffice to say that Department of Finance officials  
14 one after another admitted that in their enthusiasm  
15 for building a brave new post-war world they had been  
16 more than a trifle over-sold on the part fiscal policy  
17 could actually play in the Canadian economy. Dr.  
18 Clarke, the Deputy Minister of Finance during this  
19 period, to the time of his death from over-work,  
20 never did openly concede defeat or admit disappoint-  
21 ment.

22 157. Shelves of public works with projects to be  
23 pulled down at the appropriate moment were for various  
24 reasons found to be impracticable. Nothing ever came  
25 or, in fact, could ever easily have come from the idea  
26 of formally controlling Provincial and Municipal  
27 capital expenditures, saving them up in prosperity  
28 and pulling the plug when times were sluggish.  
29 Actually, as it has turned out, housing policy and  
30 the activities of CMHC (one of Dr. Clarke's



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launched at the appropriate moment were for various  
reasons found to be impracticable. Nothing ever came  
of, in fact, could ever really have come from the idea  
of formally controlling investment and monetary  
capital expenditures, saving them up in prosperity  
and pulling the plug when times were unpropitious.  
Actually, as it has turned out, monetary policy was  
the activities of ... (one of Dr. Gardner's





1 enthusiasms) have far exceeded in influence on the  
2 economy anything that could possibly have been  
3 achieved by regulating public works. But in this  
4 field of housing, the influence of policy seems mainly  
5 to have been pretty consistently on the side of more  
6 and more (since there has been chronic unemployment  
7 for years). So that with this powerful instrument  
8 one cannot too readily accept the opinion that housing  
9 policy will ever be used by a political government as  
10 a stabilizer but always as a stimulator in both good  
11 times and bad.

12 158. Undoubtedly welfare expenditure has added  
13 greatly to the stability of retail sales in Canada.  
14 It is amazing how in the past decade the volume of  
15 consumer buying has refused to follow the ups and  
16 downs of GNP, industrial production and employment.  
17 This is all to the good but welfare expenditure as a  
18 piece of fiscal policy can never in any sense be  
19 regarded as more than a one-sided device. It only  
20 operates one way, always up and never down. With the  
21 Parliamentarians ever the faith endures that more  
22 and more is good and from the point of view of getting  
23 elected, this is probably true since from the way  
24 welfare is financed the majority always get something  
25 for nothing.

26 General Effectiveness of Deficit and  
27 Surplus Financing

28 159. It is a bit presumptuous to attempt to do  
29 much on this question in this paper. The most that  
30 can be done is to offer the barest set of assertions



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1 and impressions. The subject needs a book at least.  
2 160. To begin with, it is next to impossible to  
3 make generalizations that will apply to all countries.  
4 It does seem, for example, that in the U.K. deficits  
5 and surpluses on budget account are regarded as of  
6 great direct significance in the economy. At least  
7 the sophisticated economic analysts seem to argue  
8 policy on the assumption that effects of almost  
9 mathematical precision on GNP, employment, balance  
10 of payments, will follow from a budget deficit or  
11 surplus position of a given amount. One cannot know  
12 without considerable study how correct these assump-  
13 tions are. Perhaps on their tight little Island  
14 things do work out pretty much as they predict. But  
15 it would, of course, be completely wrong to assume  
16 that the same sort of policies which are effective  
17 in the U.K. would necessarily have any significant  
18 similar application at all in Canada.  
19 161. Coming now to the United States, any  
20 conclusions here are bound to be pretty much guess  
21 work. There is no clear-cut record in this country  
22 that can establish the soundness of running deficits  
23 to revive a faltering economy or of budgeting for  
24 substantial surpluses to impose restraint. No one  
25 would, of course, deny that a very large deficit  
26 would give some stimulus to business in certain  
27 directions. But even so, an extreme deficit position  
28 could easily cause the sort of distrust that would  
29 seriously reduce new capital investment, particularly  
30 if it were the Democratic Party that was responsible



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1 for the policy. In the past there has, of course,  
2 been much theoretical discussion of the general  
3 virtues of cyclical financing but evidence of the  
4 practical effectiveness of it is a bit hard to come  
5 by. It seems fair to say that from a high point of  
6 unproven faith in cyclical budgeting of, say, a  
7 decade and a half ago in the U.S., there has been  
8 until recently a steady decline in support of gunshot  
9 blasts of excess spending or general across the board  
10 tax cuts as a sound method of support for a lagging  
11 economy. Certainly there has been greatly lessened  
12 support for this technique as a cure-all for general  
13 unemployment. The kind and degree of unemployment on  
14 this continent in recent years seems to call for  
15 something a little more specialized by way of remedy  
16 than spending in excess of taxing in the National  
17 Budget.

18 162. In the U.S. in the last year or so there  
19 seems to have been pretty widespread renewal of faith  
20 in the policy of spending the nation into prosperity,  
21 endorsed even by the Chamber of Commerce. Specifically,  
22 this excess of spending would be achieved by means of  
23 a tax cut across the board - corporate as well as  
24 personal, high as well as low bracket. One reads  
25 very little by way of analysis of how the expected  
26 desirable effects will work themselves out but the  
27 most common, simple conclusion seems to be that taxes  
28 are too high and are holding back business and that  
29 a general cut would give a boost to economic activity.  
30 This, of course, is pretty inadequate one-sided



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That, of course, is pretty inadequate analysis





1 reasoning and there is not much future in it as a  
2 policy unless something is done about total spending  
3 or re-arranging the incidence of the tax structure.

4 163. There is in U.S. government circles today  
5 a group of economists who have a highly developed  
6 horror of the wastefulness for the nation of unused  
7 or inactive resources - plant equipment and labour.  
8 They seem to believe that \$50 and even \$75 of pump-  
9 priming is worth it if it induces an increase of \$100  
10 in GNP. But this leaves unsolved the very practical  
11 problem of eventually getting the \$50 or \$75 back  
12 into the Treasury some time because the increase of  
13 \$100 in GNP will have gone into private pockets.

14 To be successful, a little bit of pump-priming should  
15 produce an increase in GNP, such that additional  
16 revenues at the lower rate of tax will more than  
17 restore the balance in the Budget. That this will be  
18 the final outcome in any particular set of circum-  
19 stances is pretty hard to prove or even assume.

20 164. The insidious thing about tax cutting or  
21 excess spending for speeding up business is that it  
22 usually will be to the short-run political advantage  
23 of the Party in power to have a try at it and there  
24 are plenty enough respectable economists to be quoted  
25 in support of the policy. It is not so easy for the  
26 same political government to maintain taxes or increase  
27 them in times of full employment of national resources  
28 in order to achieve a budget balance over a period.  
29 It is doubtful if this has ever happened in the U.S.,  
30 or indeed ever will happen.



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165. Furthermore, it is extremely difficult to separate in the U.S. pure fiscal techniques from impure political strategy. Fiscal policies are particularly the arguments arrayed for their defence can never be taken at face value as a safe guide for the use of similar policies in any other country, Canada for example.

166. Probably the classical case for deficit financing has less grounds for defence for use in Canada than in any other country that comes readily to mind. There are many reasons for this but one of the most important is the fact that such a large part of basic activity in Canada depends on demand for our products outside the country. Equally if not more important, is the fact that new capital investment decisions over this wide field depend mainly on foreign market prospects or indeed are directly made by businessmen abroad with foreign capital. Furthermore, a large part of secondary industry in Canada is geared to and fluctuates with activity and prosperity in our primary industries. They grew lustily and expanded mightily with and because of the thriving state of our primary industry in the prosperous post-war decade.

167. If this roughly is a fair picture of the state of affairs in Canada, it is not easy to assume that half, three-quarters or even \$2 billion deficit in the Federal Budget would help much to bring more profits, employment or new investment into Canada through selling abroad more pulp, paper, wheat,



Furthermore, it is



1 iron ore, aluminum, nickle, asbestos, oil, copper,  
2 zinc, chemicals and so on. Nor would such a deficit  
3 be expected to stimulate much new investment generally  
4 in secondary industry. In other words, deficit  
5 financing would be pretty much money down the drain in  
6 Canada. Furthermore there is quite a large leak into  
7 imports which adds nothing to business and employment  
8 in Canada.

9 168. We already have a good volume of stabilizing  
10 welfare payments in Canada - family allowances, old  
11 age pensions, old age assistance, veterans' pensions,  
12 mothers' allowances and so on. Hospital plans in all  
13 the provinces are also a big help. Unemployment  
14 insurance pours out a constant stream of spending money  
15 and within the past decade, nearly a billion in excess  
16 of current contributions has been disbursed under this  
17 heading. Federal-Provincial agreements, splitting  
18 roughly on a 50-50 basis the cost of relief for all  
19 comers who need it, employables as well as unemployables,  
20 are in force in every province. On paper at least,  
21 there is no need for anybody in Canada to go hungry  
22 or lack shelter. All in all, we seem to have done  
23 a pretty respectable job of income maintenance as  
24 security against inability to work or inability to  
25 get work. In a very real sense, therefore, deficit  
26 financing cannot be said to be as necessary or even  
27 as effective as it otherwise might be in the absence  
28 of the measures just outlined.

29 169. Canadian experience in fiscal policy since  
30 the War is fairly revealing of the benefits, difficulties



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...of the measures just outlined.  
...  
...199. Canadian experience in fiscal policy since  
...the War is fairly revealing of the parallel situation





1 and dangers inherent in this type of budget manage-  
2 ment. Fiscal policy following the War was firmly  
3 directed toward stabilizing the economy. High taxes  
4 were well maintained for several years. Excess profits  
5 taxation had disappeared in both the U.K. and the U.S.  
6 before it was repealed in Canada. In the fiscal year  
7 1946-47 expenditure was practically cut in half and  
8 a deficit of \$2,123 million for the preceding year  
9 was converted into a surplus of \$274 million. The  
10 next year the surplus was \$676 million and in the  
11 year following was \$595 million. In this period,  
12 business was booming. New investment was embarrassingly  
13 high and inflation was still a major problem. This  
14 kind of budgeting was eminently proper and no doubt  
15 helped toward slowing down price increases.  
16 170. At the same time, parliamentary debates  
17 show very clearly the punishment a political govern-  
18 ment must expect to absorb in following this unpopular  
19 policy of "stealing money from the pockets of tax-  
20 payers" and "taxing away hundreds of millions more  
21 than they need to". Such a policy takes a great  
22 deal of political courage, an amount that could be  
23 afforded only by a strongly entrenched government.  
24 So much for surplus financing.  
25 171. As for deficit financing, we have recently  
26 had occasion to learn that as fiscal policy, it can  
27 have limitations of a very real and compelling nature.  
28 The Budget this Spring came after a 4-year period with  
29 average annual "planned" deficits of over \$500 million,  
30 the latest being \$650 million. With the announcement



and foreign investment in this type of budgetary measures -  
were well maintained for several years. Excess profits  
taxation had disappeared in both the U.K. and the U.S.  
before it was repealed in Canada. In the fiscal year  
1960-61 expenditures were practically out in line and  
a deficit of \$2.325 billion for the preceding year  
was converted into a surplus of \$276 million. The  
next year the surplus was \$576 million and in the  
year following was \$485 million. In this period,  
business was booming. Now investment was substantial  
high and inflation was still a major problem. There  
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At the same time, parliamentary debates  
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The Budget that Spring came after a 4-year period with  
average annual "planned" deficits of over \$200 million  
the latest being \$680 million. With the announced



1 of an estimated \$745 million more for the current year,  
2 confidence of the investment world, particularly abroad,  
3 started coming apart at the seams. The immoderation  
4 of the following election campaign was no help. This  
5 trend towards higher deficits still in a year of really  
6 good business activity in Canada called into question the  
7 soundness of such a policy for a country which had  
8 obviously lost much of the impetus towards growth which  
9 it enjoyed in the full decade after the War. So with  
10 loss of confidence, we had a startling outflow of  
11 capital building up into a crisis, an austerity program  
12 and a start of the trek on the road back. Deficit  
13 financing as a respectable piece of fiscal doctrine for  
14 Canada will not soon recover its recent loss of stature.  
15 172. The above described "policy" of deficit  
16 financing came about simply through continuous annual  
17 increases in the volume of expenditure without any  
18 positive steps to increase revenue to pay for it. It  
19 was as simple as that. The additional spending which  
20 resulted in continuous large deficits is more than  
21 accounted for by the increase in transfer payments to  
22 the provinces during this period. By the time of this  
23 year's Budget, the cumulative increase in payments to  
24 the provinces over the base year 1956-7 was about  
25 \$2.6 billion while the cumulative deficit for the same  
26 period added up to \$2.2 billion. That is to say, if  
27 the Government had merely carried on with the previous  
28 level of payments to the provinces, they could have had  
29 a balanced budget for the period with \$400 million left  
30 over for debt reduction.





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1 173. Perhaps more often than by the method of  
2 increasing or decreasing, expenditure deficit or surplus  
3 financing is discussed in terms of tax cuts or tax  
4 increases. Involved here is a somewhat different set  
5 of important considerations which will now be briefly  
6 reviewed.

7 174. First of all, it is worthwhile in, say, a  
8 policy of cutting taxes to stimulate business, to  
9 look at the magnitude of the items in question. Today  
10 GNP is running around \$39 billion. This is the  
11 overall size of the monster to be controlled. Annual  
12 capital investment is just about at the \$9 billion  
13 mark. Retail sales are close to \$18 billion. These  
14 are items of considerable magnitude.

15 175. Looking now at the weapons, we have to use  
16 for controlling this colossus, we find that the two  
17 taxes which mainly affect consumer spending, personal  
18 income tax and sales tax, add up to about \$2.6 billion.  
19 Thus, if income tax and sales tax were both completely  
20 abolished and if people survived the shock and spent  
21 at once the whole of their tax savings, retail  
22 purchases would increase by just over 14%.

23 176. A more realistic assumption would be that  
24 personal income tax alone were to be cut by, say, 20%.  
25 This would free new purchasing power of just over \$350  
26 million. If all of this was spent, the boost to retail  
27 sales would be less than 2%. The leverage of the so-  
28 called control instruments is pitifully small. There  
29 will, of course, be some multiplier, but in periods  
30 of recession with inventories being down there is not



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Thus, if income tax and sales tax were both completely

abolished and if people survived the shock and spent

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purchases would increase by just over 10%.

176. A more realistic assumption would be that

personal income tax alone were to be cut by, say, 50%.

This would free new purchasing power of just over \$250

million. If all of this was spent, the boost to retail

called control instruments is pitifully small. These

will, of course, be some mitigation, but in periods

of recession with inventories being down there is not





1 much to count on here. All in all, it would take a  
2 pretty drastic cut in taxes to make any very substantial  
3 or significant boost to retail sales. And this leads  
4 into the next point.

5 177. One must assume the theory of budgeting for  
6 control objectives to imply that fairly substantial  
7 increases or decreases in taxes at the appropriate  
8 times will be possible and necessary in order to bring  
9 significant desirable effects. The light-hearted  
10 assumption that programs of this kind and magnitude  
11 could, in practice, be easily carried out makes one  
12 shudder. Taxes these days are such an important  
13 element in family budgets that substantial increases  
14 or purely temporary decreases could scarcely be  
15 tolerated. Most of us have to plan our financial  
16 affairs pretty carefully. Mortgage commitments, life  
17 insurance, hospital and medical plans, instalments on  
18 the car, furniture and other durables, as a rule are  
19 arranged with considerable care and thought. These  
20 closely calculated family budgets would be thrown into  
21 utter chaos by abrupt changes in income tax. Further-  
22 more, if personal taxes were cut sharply to encourage  
23 spending, the prudent person would put his tax savings  
24 aside and not spend them, knowing that before long the  
25 government will be back after it - and some more - to  
26 recoup its previous deficit. This, of course, would  
27 defeat the whole purpose of the tax cut. You just do  
28 not fool around in this fashion with high tax burdens.  
29 They are too serious. Twenty-five short years ago,  
30 federal taxes could be completely abolished or doubled



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1 over night without creating much change in anybody's  
2 way of life. This is not true any more.

3 178. What has just been said about the disruptive  
4 effects of abrupt tax changes applies, of course,  
5 mainly to personal income tax. Fiscal experts who  
6 love the idea of tax controls, however, look with  
7 special favour upon the use of sales and excise taxes  
8 as a means of draining off excess spending power. Here  
9 an entirely different set of troubles arises.

10 179. Manipulation of sales and excise taxes for  
11 control purposes may work fairly well, but only if the  
12 public is not expecting the government to use them.  
13 The public can practically ruin the effectiveness of  
14 the policy if they expect that the government is going  
15 to use them. During war-time we resorted to very high  
16 and numerous excise taxes on durable goods of various  
17 kinds. Many of these taxes were subsequently abolished,  
18 and all were at least reduced, in the post-war period.  
19 The Korean crisis immediately called for the same  
20 pattern of budget policy. Large increases in revenue  
21 were needed, and it was obviously necessary to divert  
22 productive resources from wide ranges of consumer  
23 durables for the support of defence requirements.  
24 What more natural, therefore, than that the government  
25 should resort to the re-imposition of the old excise  
26 tax program? The awkward fact was that the same idea  
27 (predicted in financial press) occurred to very large  
28 numbers of the buying public at the same time. The  
29 result was a wide-spread splurge of buying to get in  
30 ahead of the higher taxes expected in the 1951 budget.





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numbers of the buying public at the same time. The

result was a wide-spread change of buying to get in

ahead of the higher taxes expected in the 1951 budget.



1 The budget fulfilled their expectations.

2 180. The natural outcome was, of course, a bad  
3 artificial slump following the budget in most lines of  
4 business concerned, not only because of the higher  
5 prices due to tax, but also because of the pre-budget  
6 anticipatory buying. Things would not have been too  
7 bad if defence orders had been in place the very next  
8 morning ready to take up the slack. It was probably  
9 nobody's fault that this was not the case. Timing was  
10 far from perfect. In fact, there was a quite unfortunate  
11 disorganization with considerable unemployment in  
12 certain directions at a time when the policy objective  
13 was to make the most efficient use of our productive  
14 resources.

15 181. Now let us follow the sequence of events  
16 still further. Owing to the severity of the tax  
17 effects of the 1951 budget, the public became convinced  
18 that the high tax program could not last because of the  
19 drastic dislocations resulting from it. That is to say,  
20 they thought it might be worthwhile to hold off buying  
21 in the expectation of certain taxes coming down or off  
22 completely in the next budget. Again they guessed  
23 right, making the dislocations and unemployment still  
24 worse. All in all, the use of excise taxes for control  
25 purposes during the Korean crisis was a rather unhappy  
26 experience even though, according to the book, the  
27 policy made excellent sense.

28 182. Another difficulty in the free use of sales  
29 and excise tax for control purposes lies in the inventory  
30 problem. When taxes are increased, dealers with stocks



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182. Another difficulty in the free use of sales

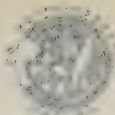
problem. When taxes are increased, dealers will raise





1 on hand rather promptly mark up their inventory and  
2 sell the next day at a price increased by the amount  
3 of the tax, even though no tax has been paid on the  
4 stocks on hand. Naturally, when taxes are lowered  
5 substantially, dealers take an inventory loss on  
6 tax-paid stocks on hand. This can be extremely  
7 disrupting and even disastrous for weaker firms.  
8 Inevitably, it causes a flood of representations to  
9 the government for relief. The seriousness of this  
10 inventory problem is shown by the events preceding the  
11 1956 budget when, through fear of a lowering of the  
12 tax on automobiles, dealers from coast to coast  
13 refused shipments of cars from manufacturers. This  
14 threatened to cause slow-downs and unemployment in  
15 the manufacturing industry. The result was that the  
16 Minister of Finance had to announce ahead of time his  
17 intention to amend the law in the forthcoming budget  
18 to enable manufacturers to ship cars on consignment  
19 without incurring tax liability. To repeat, sudden  
20 changes in excise taxes can be very troublesome and  
21 disruptive. Experience seems to show that they are  
22 not a very happy choice as an instrument for control  
23 purposes.

24 183. The corporation income tax as a fiscal  
25 instrument does not appear to fit very well at all.  
26 It is pointless to take "purchasing power" away from  
27 corporations, as might be done from the public generally,  
28 with a view to cutting down demand for consumer goods,  
29 since corporations as a rule are not in the market to  
30 any extent for most consumer items. A sharp increase



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1 in corporation taxes might, of course, result in a  
2 smaller subsequent flow of dividends, but it is  
3 problematic how far consumer buying in Canada is  
4 supported by the spending of dividend income. It is  
5 possible, of course, that instead of reducing the  
6 dividend flow, higher corporate taxes might be passed  
7 on to the consumer in higher prices - the very thing  
8 the tax policy was intended to prevent.

9 184. It is sometimes suggested, however, that  
10 because a great deal of capital expenditure is  
11 financed out of retained corporate earnings, increased  
12 corporate taxes will have a restraining effect on the  
13 investment boom which, of course, is the main cause of  
14 the trouble in a period of inflation. Higher corporate  
15 taxes would mean that corporations would have less  
16 money to invest! This might make some sense as a  
17 policy if all corporations in the country were planning  
18 capital expenditure programs. This, however, is by no  
19 means the case. It is only in some directions that  
20 business concerns are expanding rapidly! It would  
21 be rather difficult to defend a policy which penalized  
22 every corporation in order to restrain some among them  
23 who were pressing forward too fast with expansion  
24 programs. Taking people's money away from them is  
25 a pretty serious business. An attempt to restrain  
26 capital investment by a gun shot blast of higher  
27 corporate taxes would be both clumsy and unfair.

28 185. By the same token, a substantial lowering  
29 of corporate income tax in time of recession, welcome  
30 as it would be, could not be expected to induce much





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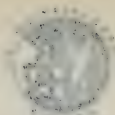
185. By the same token, a substantial lowering of corporate income tax in time of recession, when as it would be, could not be expected to induce much



1 new capital investment that otherwise would not be  
2 undertaken. Most businessmen would realize that the  
3 lower level of corporate taxes was a purely temporary  
4 phenomenon.

5 186. In attempting to assess the general  
6 effectiveness of tax policy as a method of control  
7 over the economy, it should be remembered that, in  
8 operating on the flow of purchasing power, tax policy  
9 is dealing merely with the results of inflation rather  
10 than with the causes of it. In this sense, tax policy  
11 can, in any case, be no more than a palliative and not  
12 a corrective of the fundamental problem. Taking a  
13 few hundreds of millions out of the spending stream  
14 scarcely touches at all the capital investment program  
15 which mainly creates the inflation problem.

16 187. One very awkward question faces the Minister  
17 of Finance in considering, in times of mildly rising  
18 prices, whether tax increases would be a wise move in  
19 support of a current tight money policy. The point is  
20 that none of his advisors may be able to tell him  
21 whether the price level increase is due to the pull  
22 of demand or the push of costs. One ventures to suggest  
23 that in 1956 when the consumer price index moved up  
24 by 3%, no one could have declared with certainty that  
25 it was the pull of demand that was causing it. The  
26 point is that unless the Minister of Finance had a  
27 pretty clear answer to this question, he would be at  
28 a complete loss as to whether a tax increase was the  
29 right thing or not. Furthermore, he would have to  
30 bear in mind that an income tax increase, for example,



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186. In attempting to assess the general effectiveness of tax policy as a method of control over the economy, it should be remembered that, in operating on the flow of purchasing power, tax policy is dealing merely with the results of inflation rather than with the causes of it. In this sense, tax policy can, in any case, be no more than a palliative and not a corrective of the fundamental problem. Taking a few hundreds of millions out of the spending stream scarcely touches at all the capital investment program which mainly creates the inflation problem.

187. One very awkward question faces the Minister of Finance in considering, in times of mildly rising prices, whether tax increases would be a wise move in support of a current tight money policy. The point is that none of his advisors may be able to tell him whether the price level increase is due to the pull of demand or to the push of cost. The answer is that in 1935 when the price level rose by 3%, no one could have declared with certainty that it was the pull of demand that was causing it. The point is that unless the Minister of Finance had a pretty clear answer to this question, he would be at a complete loss as to whether a tax increase was the right thing or not. Furthermore, he would have to bear in mind that an income tax increase, for example,





1 resulting in a cut in take-home pay might, in a tight  
2 labour situation, be the basis for a new round of wage  
3 increases. If this did happen, his policy would be  
4 doubly defeated. That is, consumer demand would have  
5 been maintained and pressure from the cost structure  
6 would have brought about further price increases.  
7 188. In such a situation just outlined where  
8 there were good grounds for expecting a price level  
9 increase, a restrictive bank policy would still make  
10 good sense regardless of which of the two factors - the  
11 pull of demand or the push of costs - was responsible;  
12 because some restraint on investment would operate not  
13 only to reduce tensions in the cost structure but also  
14 to slow down the flow of spendable incomes. The point  
15 being made here is that, while proper Bank Policy would  
16 be quite clear, the appropriate Tax Policy would not  
17 by any means be obvious. No Minister of Finance, with  
18 taxes already at a very high level, would relish the  
19 idea of raising them still higher in prosperous times  
20 just on the off-chance that it might possibly be the  
21 right thing to do.

22 189. There is an awful lot of pretty glib, vague  
23 and hollow talk and writing these days about what the  
24 government can and should do about so-called fiscal  
25 policy. In substance, it adds up to very little.  
26 Some years ago, when Geoffrey Crowther was retiring  
27 from Editorship of The Economist, he commented on the  
28 way governments today take upon themselves full  
29 responsibility for the state of the economy. He  
30 followed this by an expression of marvel at their



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1 presumption in view of the very puny little instruments  
2 they have at their disposal for backing up such claims.  
3 How much more should he marvel in viewing the situation  
4 in Canada!

5 Death Duties - Liquidity Problem

6 190. It was suggested that comment might be  
7 offered in this memorandum on the problem of meeting  
8 payments called for under death duties (presumably  
9 Federal estate tax and Provincial inheritance taxes).  
10 The question relates not to the absolute burden of the  
11 tax but the problem of arranging affairs to have  
12 sufficient liquid assets on hand to meet the payments  
13 within the required time. Possibly the main point of  
14 concern here is whether death duties in Canada have  
15 the effect of driving the family type of business into  
16 selling out - assets or shares - to public companies,  
17 particularly foreign public companies, in order to  
18 meet tax obligations. If this were so, it would be  
19 regarded as bad.

20 191. Perhaps as a general rule it can be said  
21 that insurance is the greatest source of liquidity  
22 in estates in Canada. The addiction of Canadians to  
23 insurance is something to marvel at. It is very  
24 useful, however, as a source of ready cash to meet  
25 death duties. Normally also, most estates will show  
26 fairly substantial holdings of marketable securities,  
27 bonds which have a ready market and stocks of a type  
28 and diversity that create no problem upon fairly quick  
29 realization.

30 192. The greatest liquidity problem arises,





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IN 1901

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and diversity that create no problem upon fairly prompt

realization.

THE PROBLEM OF DEATH DUTIES IN CANADA



1 of course, in estates where the sole or main asset is  
2 in the form of "any income right, annuity, term of  
3 years or life or other similar estate". Here, the  
4 Federal law allows the tax applicable to such property  
5 to be spread over six years without interest. There  
6 are no such special provisions relating particularly  
7 to the situation where the main asset is a closely  
8 held family business - a going concern. There is,  
9 of course, a general provision in the law which gives  
10 the Minister discretion to postpone tax (with interest  
11 up to 5%) if he thinks the payment of it would cause  
12 "undue hardship or excessive sacrifice". It is not  
13 to be expected, however, that the necessity of selling  
14 out a family business at a fair price, where no  
15 preparation had been made by the deceased for meeting  
16 taxes on his death, would be regarded by the Minister  
17 as either hardship or sacrifice. It would probably be  
18 looked upon as just plain carelessness.

19 193. In approaching this question of liquidity  
20 in the case of closely held family businesses, there  
21 is no point in attempting to sidestep the fact that  
22 death duties are very high in Canada. Plenty of  
23 family businesses are worth \$1-2 million. The tax  
24 (Federal and Provincial combined) on \$1 million is  
25 just over \$300,000 and on \$2 million, it is nearly  
26 \$800,000. From a \$5 million estate, the tax would  
27 take close to half (54% rate applies on excess over  
28 \$2 million). Quite clearly, the so-called liquidity  
29 problem can be quite acute for estates of this size  
30 made up mainly of a single asset, a family business.

in estates where the sole or main asset is in the form of "any income right, annuity, term of Federal law allow the tax apportionable to such property to be spread over six years without interest. There are no such special provisions relating particularly to the situation where the main asset is a closely held family business - a going concern. There is, of course, a general provision in the law which gives the deceased a right to spread the tax over six years up to 5% if he thinks the payment of it would cause "undue hardship or excessive sacrifice". It is not to be expected, however, that the necessity of selling out a family business at a fair price, where no preparation had been made by the deceased for meeting taxes on his death, would be regarded by the Minister as either hardship or sacrifice. It would probably be looked upon as just plain carelessness.

193. In approaching this question of liquidity in the case of closely held family businesses, there is no point in attempting to elude the fact that death duties are very high in Canada. Twenty of family businesses are worth \$1-2 million. The tax (Federal and Provincial combined) on \$1 million is just over \$300,000 and on \$2 million, it is nearly \$600,000. From a \$2 million estate, the tax would take close to half (50% rate applies on excess over \$2 million). Quite clearly, the so-called liquidity problem can be quite acute for estates of this size made up mainly of a single asset, a family business.

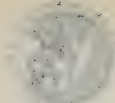




1 194. For smaller businesses, the problem is not  
2 nearly so acute. For a business worth \$160,000  
3 (\$60,000 exemption for married), the tax would be  
4 \$19,000. The man might have insurance enough to cover  
5 this and his son would be able to take over the  
6 business unimpaired.

7 195. An estate made up of a \$260,000 business  
8 would have to pay \$44,000 tax. Ordinary life  
9 insurance might not be expected to take care of all  
10 of this, so a Trust Company might have to be called  
11 upon to arrange for a mortgage on some of the business  
12 property for, say, \$25,000. This should be practicable  
13 with no particular problem of retaining family control.  
14 Mortgage interest will, of course, cut into the flow  
15 of income to his heirs but this has to be expected.  
16 At the same time, the interest charge against the  
17 business is a deduction in computing profits for  
18 corporate tax purposes.

19 196. At the \$560,000 level the problem is getting  
20 a bit worse! Here, nearly \$150,000 will have to be  
21 found. Insurance can no longer be counted on to take  
22 care of much of the tax unless the deceased had been  
23 foresighted enough to have over the years taken out  
24 an insurance-endowment policy specifically to meet  
25 death duties. Mortgages of higher amounts may have  
26 to be resorted to. Even so, it is reasonable to  
27 assume that up to the half million mark, there is no  
28 very good case for saying that the tax forces people  
29 to sell out a family business to a public company.  
30



For a business worth \$500,000

(\$50,000 exemption for married), the tax would be

\$10,000. The man might have insurance enough to cover

this and his son would be able to take over the

195. An estate made up of a \$500,000 business

would have to pay \$44,000 tax. Ordinary life

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very good case for saying that the tax forces people

to sell out a family business to a public company.



1 197. For a business of \$750,000, the tax is just  
2 over \$200,000, which calls for some pretty substantial  
3 financing. It would, however, still allow for a  
4 fairly reasonable equity-debt ratio for the business  
5 if a large portion of this tax liability were raised  
6 through mortgages. Interest, of course, would be  
7 cutting deeply into earnings of the heirs but if the  
8 business were fairly profitable with good prospects,  
9 there should be no real hardship. Still, not a very  
10 good case could be made for abatement in tax provisions.

11 198. ~~It is~~ It is for estates of \$1 million up that the  
12 so-called liquidity problem becomes acute. It was  
13 mentioned above that for a \$1 million estate, the tax  
14 is over \$300,000, for \$2 million, nearly \$800,000 and  
15 for \$5 million, about \$2½ million. One cannot expect  
16 that tax money in these proportions will be available  
17 without careful planning a long time ahead. For the  
18 \$5 million estate, it is too much to expect to have  
19 business as usual after the government has taken away  
20 half of it. Such a family business could only be  
21 continued as such if over a period of a good many  
22 years the proprietor had systematically built up a  
23 heavy position of liquid assets outside the business.  
24 He may have decided long ago that it was not worth it  
25 and accordingly, today finds himself among those who  
26 complain about taxation closing up his family business,  
27 having to sell out to pay tax! It is, of course,  
28 next to impossible to get a decent price for unlisted  
29 minority shares in a family-controlled business.





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1 199. This is a real problem and it is deplorable.  
2 Undoubtedly, the tax will have the effect of closing  
3 up family businesses. At the same time, one cannot  
4 readily see how this can be avoided in a socialistically-  
5 minded free enterprise democracy. If the public support  
6 the idea of taking into the public treasury one-half  
7 of a five million dollar estate there is not much one  
8 can do about it. It is just one of those things.  
9 Some discussion of this problem implies that the tax  
10 somehow favours a take-over by foreigners. There is  
11 nothing in this. It merely makes it sound worse.

12 200. Strictly speaking, the problem is not one of  
13 liquidity in the sense that it is in the case of an  
14 annuity where only a bit of time is needed in order to  
15 meet the payment. But six years in which to pay would  
16 not help a great deal in meeting the two-and-a-half  
17 million dollar tax on a five million dollar business.  
18 The point is that the tax is too large for devices of  
19 this sort to help much. They might help a little  
20 but probably not enough to forestall the almost  
21 inevitable result of selling out in the absence of  
22 long preparation.

23 201. Most estates under a million dollars do  
24 not really need a modification of tax law. It is  
25 hard, then, to imagine a Minister of Finance appealing  
26 to the House of Commons for some amelioration of the  
27 Estate Tax burden on, say, a five million dollar  
28 business. The public could not be expected to understand  
29 the problem and probably would not care a damn if they  
30 did. The government sponsoring this kind of relief



1 This is a real problem and it is before  
 2 Undoubtedly, the tax will have the effect of clearing  
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1 would get merely horse-laughs from the Opposition.  
2 202. The Income Tax law has gone quite a long  
3 and complicated way in attempting to make life tolerable  
4 for a privately-owned business. Usually, this kind of  
5 business grows and expands out of retained earnings.  
6 The result is that most of them have on hand large  
7 undistributed income. Very careful track is kept of  
8 this kind of retained earnings to prevent tax avoid-  
9 ance. Upon the winding up of such a company, the  
10 whole of this undistributed income on hand is deemed  
11 to be a dividend and with the piling-up of this much  
12 income in one year, the tax could be excruciating.  
13 During war time, the situation became simply fantastic.  
14 Tax rates at that time were so high that even with, say,  
15 a million dollar dividend, the taxpayer could not retain  
16 more than about \$27,000. If, under these conditions,  
17 the proprietor of a family business died, the only  
18 way he could possibly meet his estate tax would be to  
19 sell the shares of his business and no one would be  
20 very anxious to buy the shares of such a company with  
21 this potential tax liability overhanging its surplus.  
22 203. The solution finally worked out was to  
23 allow the company itself to pay a 15% tax on this  
24 undistributed income and thus create "tax paid"  
25 undistributed income which thereupon might be  
26 distributed to shareholders free of personal income  
27 tax. Any company may do this today on income  
28 accumulated up to 1949. From 1949 onward, they may  
29 qualify one half their earnings for this treatment  
30 by paying out the other half.



202. The income tax law has gone quite a long

and complicated way in attempting to make life tolerable

for a privately-owned business. Usually, this kind of

business grows and expands out of retained earnings.

The result is that most of them have on hand large

undistributed income. Very earnest work is kept of

this kind of retained earnings to prevent tax avoid-

ance. Upon the winding up of such a company, the

whole of this undistributed income on hand is deemed

to be a dividend and with the piling-up of this money

the situation becomes simply fantastic.

During war time, the situation became simply fantastic.

Tax rates at that time were so high that even with a

a million dollar dividend, the taxpayer could not raise

more than about \$25,000. If, under these conditions,

the proprietor of a family business died, the only

way he could possibly meet his estate tax would be to

sell the shares of his business and no one would be

very anxious to buy the shares of such a company with

this potential tax liability overhanging its surplus.

203. The solution finally worked out was to

allow the company itself to pay a 15% tax on this

undistributed income and thus create "tax paid"

undistributed income which thereupon might be

distributed to shareholders free of personal income

tax. Any company may do this today on income

accumulated up to 1942. From 1942 onward, they may

qualify one half their earnings for this treatment

by paying out the other half.



1 204. Today, the corporate tax on income up to  
2 \$35,000 is only 21%, with a 20% dividend tax credit.  
3 This is fairly lenient tax treatment. The proprietor  
4 of the business can then gradually create tax paid  
5 undistributed income on hand and thus put himself in  
6 a position to borrow money on mortgage from his  
7 business and provide liquid funds for meeting estate  
8 tax. It is suggested here that the way has been paved  
9 as far as is reasonably possible to enable family  
10 control of businesses in Canada to be maintained.

11 Tax Status for Credit Unions

12 205. Doubtless the Commission will have received  
13 argument from various classes of financial companies  
14 that the income tax exemption for Credit Unions is  
15 terrible and should be withdrawn. Doubtless also,  
16 Credit Unions will maintain that it is just right and  
17 should be retained. It has been suggested that this  
18 memo might comment on the situation pro and con.

19 206. Almost invariably, emotions promptly creep  
20 or more often barge - into any discussion about co-  
21 operatives. The leaders of the movement are evangelistic  
22 types who are inclined to look hurt or sorrowful at the  
23 very idea of any interference in their good works by  
24 the State. Private business, of course, resents their  
25 very existence and usually have an exaggerated fear  
26 of their potential. A bit of a cold war is carried  
27 on in annual Briefs to the government. Mostly this is  
28 pretty harmless sniping at each other. There are some  
29 recent signs that the question may hot up again.  
30





204. Today, the corporate tax on income up to \$50,000 is only 15%, and the dividend tax is 15%. This is really a very low rate. The government has to be careful not to let the corporate tax rate go too high. Undistributed income on hand and thus put himself in a position to borrow money on mortgage from his business and provide liquid funds for meeting estate tax. It is suggested here that the way has been paved as far as it is reasonably possible to enable family control of businesses in Canada to be maintained.

Tax Status for Credit Unions

205. Doubtless the Commission will have received argument from various classes of financial companies that the income tax exemption for Credit Unions is terrible and should be withdrawn. Doubtless also, Credit Unions will maintain that it is just right and should be retained. It has been suggested that this memo might comment on the situation pro and con.

206. Almost invariably, emotions promptly creep in or more often barge in into any discussion about co-operatives. The leaders of the movement are evangelists types who are inclined to look hurt or sorrowful at the very idea of any interference in their good works by the State. They are usually very sincere and usually have an exaggerated fear of their potential. A bit of a cold war is carried on in annual battles to the government. Mostly this is done by the State, which is usually the one who is most anxious to keep the question may not up again.



1 207. While the Co-Operative Union of Canada  
2 does not regard the Credit Unions and Caisses Populaire  
3 as directly under their wing possibly they can be  
4 expected, on general principles, to use some of their  
5 not inconsiderable political influence to preserve the  
6 tax status quo for the Credit Unions. They operate  
7 under the same general philosophy.

8 208. If the defence of the tax exemption for  
9 Credit Unions is to rest on "co-operative principles",  
10 it would be well to have a look at the general tax  
11 law which covers co-operatives and see whether it is  
12 appropriate for the special field of Credit Unions.

13 209. All in all, we have in Canada, pretty  
14 sensible tax laws for co-operatives. Actually, the  
15 main provision which alleviates their tax position  
16 is not limited to co-operatives at all but applies  
17 to any company. Any company which holds forth the  
18 prospect of patronage dividends to its customers may  
19 deduct the amounts disbursed in this way in computing  
20 its income for tax purposes. It is sensible in a  
21 free country that any company should be allowed to  
22 hand back profits to its customers, i.e., giving them  
23 a year-end discount on their purchases from the  
24 corporation or an additional payment to its customers  
25 on its purchases from them. It may choose to do this  
26 instead of passing out dividends to shareholders as  
27 a return on their capital. This is the form of doing  
28 business. There is no special privilege in this tax  
29 provision. It merely recognizes one of the ordinary  
30 practices in doing business. Profit-sharing plans are



While the Co-operative Union of Canada

197

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its income for tax purposes. It is sensible in a

free country that any company should be allowed to

hand back profits to its customers, i.e., giving them

a permanent dividend as part of the return on their

corporation or an additional payment to its customers

on the purchase from them. It may choose to do this

in the form of a dividend or in some other way.

a return on their capital. This is the form of doing

business. There is no special privilege in this tax

provision. It merely recognizes one of the ordinary

methods of doing business. The provision is not





1 not uncommon in private industry.

2 210. There is a rather curious provision limiting  
3 the deduction of patronage dividends. The deduction  
4 may not reduce taxable income below 3% of capital  
5 employed. The theory was that capital has its own  
6 earning power independent of the form of business and  
7 this piece of earnings should not and could not logically  
8 be paid out to customers as a reward for patronage.  
9 This obviously is a bit far-fetched but there it  
10 stands. It is hard to see why a company should not  
11 be allowed to dish out whatever it likes as a bonus  
12 for patronage. The source of its funds should not  
13 matter.

14 211. Actually, to qualify for deduction,  
15 patronage dividends do not have to be disbursed in  
16 cash. They can be declared and credited to members.  
17 This in law constitutes payment. A company by-law  
18 may then require the members to leave the amount on  
19 loan with the company for a period of years. In this  
20 way, through the revolving fund technique, the co-op  
21 gets its working capital pretty cheaply. No ordinary  
22 business concern, of course, could do this but in  
23 defence of the practice, it might be said that it is  
24 simply one of the inherent by-products in the co-op  
25 method of doing business and cannot legitimately be  
26 complained about by private business as special tax  
27 privilege. If a co-op wants to impose forced savings  
28 interest free or at a low rate on their members, they  
29 surely have the right to do so. No one else should  
30 complain.



There is a rather curious provision limiting the deduction of patronage dividends. The deduction may not reduce taxable income below 2% of capital employed. The theory was that capital was its own earning power independent of the form of business and this place of earnings should not and would not logically be paid out to customers as a reward for patronage. This obviously is a bit far-fetched but there it stands. It is hard to see why a company should not be allowed to dish out whatever it likes as a bonus for patronage. The source of its funds should not matter.

211. Actually, to qualify for deduction, patronage dividends do not have to be disbursed in cash. They can be declared and credited to members. This in law constitutes payment. A company by-law may then require the members to leave the amount on loan with the company for a period of years. In this way, through the revolving fund technique, the co-op gets its working capital pretty cheaply. No ordinary business concern, of course, could do this but in defence of the practice, it might be said that it is simply one of the inherent by-products in the co-op method of doing business and cannot legitimately be complained about by private business as special tax privileges. If a co-op wanted to impose forced savings interest free or at a low rate on their members, they surely have the right to do so. No one else should



1 212. Co-ops upon formation are given a three  
2 year exemption. This is special privilege otherwise  
3 reserved exclusively in the tax law for mining companies.  
4 There is no good case for it and it spoils the purity  
5 of an otherwise defensible tax position for co-operatives  
6 (except for the 3% rule).

7 213. Perhaps we might start the discussion of the  
8 Credit Union tax position by saying that on general  
9 principles all outright exemptions from tax are bad.  
10 The second point which might be made is that as a  
11 general rule in tax legislation, a benefit once uttered  
12 can never be recalled. However, it is not as if Credit  
13 Unions had once been taxable and were then overtly  
14 granted a benefit. It is merely that when co-ops  
15 generally were deprived of their tax-exempt status  
16 following the McDougall Commission Report, the Credit  
17 Unions were left outside. The Report recommended  
18 that they be left alone! The Minister of Finance  
19 accepted this recommendation. At the time the  
20 movement was mainly centered in rural Quebec and it  
21 is not too surprising therefore, that the Minister  
22 went along with the recommendation. Of total assets  
23 in 1943 of \$69 million for Canada as a whole, about  
24 \$61 million (88%) was on the books of Caisses Populaires  
25 in Quebec.

26 214. In the meantime, Credit Unions have had a  
27 phenomenal growth. They are now big business. Assets  
28 have moved up from \$69 million in 1943 to \$1,299 million  
29 in 1960 with only 51% of assets in Quebec. They now  
30 have more than 2.6 million members.





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in 1960 with only 2% of assets in Quebec. They now  
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215. The arguments in the McDougall Report for continued tax exempt status for Credit Unions were based mainly on the position of small rural Unions in Quebec. Today these arguments are not impressive at all for organizations with assets of \$1.3 billion, membership of 2.6 million with 4,667 offices from coast to coast, less than 35% of which are classified as rural.

216. It is all right and noble to encourage "people in poor circumstances to develop habits of thrift" but let us not try to visualize 2.6 million Canadians as in poor circumstances. And probably through the good offices of Credit Unions as many are being encouraged to borrow as to save, which is all right too.

217. "We are satisfied that credit unions perform a highly useful function in assisting people who are unable to take effective advantage of savings and loan facilities provided by other lending institutions." Of course, they perform a useful function but it would be going a bit far to suggest in 1960 that the 2.6 million people they are assisting "are unable to take effective advantage of savings and loan facilities provided by other lending institutions": Not many people in the country are more than half an hour by car away from a branch of a chartered bank. Few city and town dwellers are more than a few minutes walk away from a small loan company office or a branch bank. Trust companies fill in in the large towns and cities. Over the radio, by T.V., and in daily and



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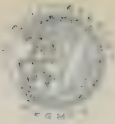
1 weekly newspapers, these companies plead for more  
2 customers. Lack of facilities for borrowing or saving  
3 is scarcely a problem these days. The country is stiff  
4 with them.

5 218. Arguments for exemption, (b) (c), in the  
6 McDougall Report are these:-

7 (b) The bond of association, occupation  
8 or other community interest on which the  
9 membership of credit unions is based tends  
10 to minimize the element of risk which has  
11 to be considered by another type of lending  
12 institution when considering an application  
13 for a loan from an individual with little  
14 or no collateral security;

15 (c) Accordingly, it provides a service for  
16 those who are either not provided with  
17 credit services from other lending  
18 institutions at all, or only at much higher  
19 rates because of the risks involved.

20 219. There is no doubt about it Credit Unions  
21 can lend money more cheaply - with less risk - to  
22 their fellow members than can a small loan company  
23 to its customers. A small loan company has to start  
24 cold when a customer walks in off the street and  
25 wants money. The total cost of making small loans is  
26 by no means represented by the cost of securing money  
27 to re-lend. It is a very expensive, time consuming  
28 and tricky business to find out whether the customer  
29 will be both willing and able to pay back the money  
30 he has borrowed. In a Credit Union, the Credit



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1 Committee, if they are any good, will know these  
2 things about the applicant and can almost automatically  
3 - and without expense - give a yes or no to an  
4 application for a loan. In Ontario the maximum which  
5 may be charged by a Credit Union is 1% per month on  
6 the unpaid balance. A tough-minded Parliament allows  
7 small loan companies to charge 2% per month on loans  
8 up to \$300 and they do, in fact, charge ceiling rates  
9 on everything up to \$1,500. Credit Unions frequently  
10 make instalment loans at 3/4% or 1/2% per month on  
11 unpaid balances. For term loans, the rates may vary  
12 from 6% to 9% per annum. On this kind of business  
13 at these rates they apparently make profits and pay  
14 patronage dividends.

15 220, A few conclusions may now be drawn:-

16 (a) Credit Unions on a rate basis are  
17 not vulnerable to competition from  
18 private financial institutions.

19 (b) They do not need tax exemption in  
20 order to fulfill their mission of self-help.

21 (c) Where they have built up the reserve  
22 required under provincial law, they are  
23 not supposed to be in business to make  
24 a profit anyway, so why should they need  
25 exemption from a tax on profits?

26 221. "We are also satisfied that credit unions  
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28 prise, except to provide an alternative source of  
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1 facilities at comparable net rates". This statement  
2 seems to imply that the volume of business of private  
3 institutions in the small loan field is not really  
4 injured in any way by the activities of Credit Unions.  
5 Whatever might be said of the situation in 1943 when  
6 personal loans by Credit Unions probably did not exceed  
7 \$10 million would scarcely be true in 1960 when  
8 personal loans made by Credit Unions were about \$425  
9 million. This compares with only \$392 million of  
10 small loan balances outstanding on the books of all  
11 small loan companies and licensed money lenders in the  
12 same year. These figures suggest that in the small  
13 loan business co-operatives have cut into private  
14 business on a grand scale. It is not suggested that  
15 all of the \$425 million small loan business of the  
16 Credit Unions would otherwise have gone to private  
17 loan companies and banks but it is safe to assume that  
18 quite a large part of it would have. It would not be  
19 surprising therefore, if small loan companies and the  
20 banks were to complain pretty bitterly about the  
21 favoured position of Credit Unions through tax exemption.  
22 At the same time, it almost goes without saying that  
23 the private enterprise fellow will vastly over-rate  
24 the importance of the tax exemption in their competitive  
25 position vis-à-vis Credit Unions.

26 222. From the above, it does seem that there is  
27 a clear case for recommending the repeal of Section  
28 62 (1) (k) of the Income Tax Act which exempts Credit  
29 Unions from tax. They would then fall to be taxed  
30 as ordinary companies and would be allowed to deduct



Small Loan Companies  
and Credit Unions

facilities at comparable net rates". This statement seems to imply that the volume of business of private institutions in the small loan field is not really injured in any way by the activities of Credit Unions. Whatever might be said of the situation in 1943 when personal loans by Credit Unions probably did not exceed \$10 million would scarcely be true in 1960 when personal loans made by Credit Unions were about \$425 million. The small loan business is not a new business. Small loan balances outstanding on the books of all small loan companies and licensed money lenders in the same year. These figures suggest that in the small loan business co-operatives have not gone out into private business on a grand scale. It is not suggested that all of the \$425 million small loan business of the Credit Unions would otherwise have gone to private loan companies and banks but it is safe to assume that quite a large part of it would have. It would not be surprising therefore, if small loan companies and the banks were to complain pretty bitterly about the favored position of Credit Unions through tax exemption. At the same time, it almost goes without saying that the relative importance of the tax exemption in their competitive position vis-a-vis banks is not as great as it seems. From the above, it does seem that there is a clear case for recommending the repeal of Section 62 (1) (x) of the Income Tax Act which exempts Credit Unions from tax. They would then fall to be taxed as ordinary companies and would be allowed to deduct





1 patronage dividends if they held out the prospect of  
2 them to their members - which most of them do. The  
3 limitation (3% of capital employed) on the deduction  
4 would likewise apply. It appears also that the three  
5 year initial exemption would likewise apply to them  
6 since they are incorporated under special provincial  
7 co-operative legislation. All of this means simply  
8 that they would be treated for tax purposes the same  
9 as any other co-operative.

10 223. This sounds all very simple and straight-  
11 forward but the Commission should know that it might  
12 mean that Credit Unions (at least in Ontario) would  
13 have to revise their systems pretty drastically to  
14 avoid paying quite a bit of tax. On the other hand,  
15 it should not (in substance at least), cause much  
16 trouble in Quebec.

17 224. The point is that in Ontario, most of the  
18 funds (savings) put in Credit Unions is through the  
19 purchase of \$5 shares (\$140.7 million) and only a  
20 relatively small amount is put in in the form of  
21 savings deposits, (\$10.7 million). In Quebec, only  
22 \$60 million was put in as share capital and \$596  
23 million as savings deposits. The first point is that  
24 "the amount paid pursuant to a legal obligation to  
25 pay interest" is deductible in computing profits for  
26 tax purposes while the amount paid out as dividends  
27 is, of course, not deductible.

28 225. As a matter of fact, it seems almost certain  
29 that in Ontario, the so-called interest paid on  
30 savings deposits would not qualify as a deduction since



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there does not seem to be any legal obligation to pay anything on deposits. Published Standard By-Laws state simply that interest may be paid on deposits. And as a matter of practice, the Board of Directors of each Union decide each year what they will pay each year. There is nothing fixed or certain about the rate. It may vary from year to year just as dividends on shares may vary from year to year.

Actually, there does not seem to be much essential difference between share capital and deposits.

226. This is a pretty confused and slap-happy situation. Apparently, the idea of taking members' savings in the name of share capital rather than savings deposits is to give the member the feeling that the company is his - he owns a piece of it - and that his Union is not merely an independent corporation that owes him the money he has deposited with it. One other reason mentioned is that sixty days' notice may be required for redemption of shares while only thirty days may be required for withdrawing deposits - (this sounds a bit phony).

227. The writer has not taken the time nor spent the money to get a legal opinion on the status of so-called interest payments on deposits in other provinces. He has been told that the legal distinction between the position of shareholder and depositor is pretty clearly established in Quebec. In all provinces, the rule is one member, one vote, regardless of share ownership.





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1 228. If Credit Unions do not wish to bind them-  
2 selves to much of a fixed contractual rate of interest  
3 for a year, it would seem quite simple for it to call  
4 the voluntary interest in excess of say, 1%, a patronage  
5 dividend, that is, a year-end payment to the customer  
6 (depositor) for having left savings with the company.  
7 It is already common practice to pay patronage divid-  
8 ends to borrower customers, a 10% to 15% refund of the  
9 interest he has paid to the Union during the year.  
10 The Unions' customers are both borrowers and lenders.  
11 There is no obvious reason why they should not both  
12 get patronage dividends, with the lenders getting the  
13 same amount (less a fraction), which they now get in  
14 the name of voluntary interest. It is clear, however,  
15 that Credit Unions would have to pay tax on the profits  
16 now disbursed as dividends on share capital (Ontario,  
17 for example) unless they change the form of the paper  
18 they hand out from a share certificate to a deposit  
19 certificate with a low fixed rate of interest and with  
20 the prospect of a patronage dividend taking the place  
21 of an ordinary dividend on share capital.

22 229. In view of the 20% tax credit for dividends  
23 received from taxable corporations, there should not be  
24 really much substance to any opposition by Credit  
25 Unions to the removal of their tax exemption. The  
26 removal of the exemption would make Credit Unions  
27 taxable corporations. Probably after deduction of  
28 interest and patronage dividends few Credit Unions  
29 will have taxable income in excess of \$35,000. This  
30 means that as a rule their federal and provincial



Ontario, Canada

A. 107

228. If Credit Unions do not wish to bind themselves to much of a fixed contractual rate of interest for a year, it would seem quite simple for it to call the voluntary interest in excess of say, 1%, a patronage dividend, that is, a year-end payment to the customer (patronage dividend). It is already common practice to pay patronage dividends to borrower customers, a 10% to 15% return of the interest he has paid to the Union during the year. The Unions' customers are both borrowers and lenders. There is no obvious reason why they should not both get patronage dividends, with the lenders getting the same amount (less a fraction), which they now get in the name of voluntary interest. It is clear, however, that Credit Unions would have to pay tax on the profits now disbursed as dividends on share capital (Ontario, for example) unless they change the form of the payment they hand out from a share certificate to a deposit certificate with a low fixed rate of interest and with the prospect of a patronage dividend taking the place of an ordinary dividend on share capital.

229. In view of the 20% tax credit for dividends received from taxable corporations, there should not be really much substance to any opposition by Credit Unions to the removal of their tax exemption. The removal of the exemption would make Credit Unions taxable corporations. Probably after deduction of interest and patronage dividends few Credit Unions will have taxable income in excess of \$25,000. This means that as a rule their federal and provincial





1 corporate tax combined will not usually exceed 21% or  
2 22%. Nearly all shareholders who pay income tax - and  
3 it is fair to assume that most of them do - will be  
4 able to offset against their personal income tax the  
5 tax paid upstairs by the corporation on dividends  
6 distributed to them. This may undermine to some  
7 extent the opposition to a change-over. However,  
8 particularly in the rural Credit Unions and Caisses  
9 Populaires, there will be some who, because of large  
10 personal exemptions will pay no income tax. They will  
11 receive no offset and accordingly, will have some  
12 remaining basis for complaint against the change-over.

13 230. Credit Unions which are not old enough to  
14 have built up the reserve required by provincial law  
15 (10% of share capital and deposits) would always be  
16 taxable on the amounts transferred each year to the  
17 Guarantee Fund. 20% of yearly net profits have to be  
18 set aside until the fund reaches the 10%. A 21% tax  
19 on 20% of net earnings is not a very heavy tax burden  
20 and would not slow down very much the growth of  
21 reserves but, of course, it would be complained of as  
22 hitting the weakest of the lot. This, of course,  
23 is a bad feature but all private business has to build  
24 reserves out of tax paid money so let us not weep over  
25 the situation. It happens to everybody now except  
26 Credit Unions. It would, of course, be wrong in  
27 principle to allow in federal legislation a deduction  
28 for amounts transferred to reserve under a requirement  
29 of provincial law.  
30



corporate tax combined will not usually exceed 21% or  
22%. Nearly all shareholders who pay income tax - and  
it is fair to assume that most of them do - will be  
tax paid upstate by the corporation on dividends  
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Credit Unions. It would, of course, be wrong in  
principle to allow in general legislation a deduction  
for amounts transferred to reserves under a requirement  
of provincial law.



231. SUMMARY

- (a) The arguments of the McDougall Report for Credit Union exemption no longer have any significant validity.
- (b) The present exemption Section 62 (1) (k) of the Income Tax Act should be repealed.
- (c) In the absence of the present exemption Credit Unions would fail to be taxed in the same manner as any other co-operative.
- (d) Allowing patronage dividends as a deduction is eminently sensible in law taxing the profits of corporations. The 3% limiting provision is an illogical penalty. The three year exemption is undeserved privilege.
- (e) There is a very awkward situation, particularly in Ontario, and possibly in all provinces regarding the deductibility of interest payments since generally they seem to be entirely voluntary without legal obligation.
- (f) In Ontario particularly and possibly in most provinces except Quebec Credit Unions may find it desirable from the tax point of view to convert shares into deposit certificates.
- (g) Credit Unions may find it expedient to pay patronage dividends to lenders as well as to borrowers if they do not wish





(a) The arguments of the Newfoundland Paper for Credit Union exemption no longer have any significant validity.

(b) The present exemption Section 89 (1) (k) of the Income Tax Act should be repealed.

(c) In the absence of the present exemption Credit Unions would have to be taxed in the same manner as any other co-operatives.

(d) Allowing patronage dividends to be deducted is extremely beneficial in tax taxing the profits of corporations. The 3% limiting provision is an illegitimate penalty. The three year exemption is an unwarranted privilege.

(e) There is a very serious situation, particularly in Ontario, and possibly in all provinces regarding the deductibility of interest payments since generally they seem to be entirely voluntary without legal obligation.

(f) In Ontario particularly and possibly in most provinces except Quebec Credit Unions may find it desirable from the tax point of view to convert shares into debenture certificates.

It is suggested that the Government should be pay patronage dividends no longer as well as to determine if they do not wish

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1 to contract for more than a small amount  
2 of annual interest on deposits.

3 (h) The 20% dividend tax credit will  
4 recoup most members for the tax paid  
5 upstairs by the Union.

6 (i) Amounts still to be transferred to  
7 Guarantee Fund would bear tax in future  
8 but there is nothing wrong with this.  
9 All private companies do too.

10 (j) Making Credit Unions taxable will not  
11 slow down their growth or hurt their  
12 existence appreciably. This is another  
13 way of saying that a 21% tax on a small  
14 profit margin will make little difference  
15 in the gross lending rate or the gross  
16 rate paid on deposits. The competitive  
17 advantage through tax exemption alone  
18 reflected in the rate structure could be  
19 put in your eye. Removal of the exemption,  
20 however, would wipe out the strong feeling  
21 of resentment that exists today because of  
22 the privileged position of Credit Unions  
23 in tax law. It should be removed.



to determine the amount of a small amount

of annual interest on deposits.

(h) The 20% dividend tax credit will

receive most members for the tax paid

operating by the Union.

(i) Amounts still to be transferred to

Guarantee Fund would bear tax in future

but there is nothing wrong with this.

All private companies do too.

(j) Making Credit Union taxable will not

slow down their growth or hurt their

existence significantly. This is another

way of saying that a 2% tax on a small

profit margin will make little difference

in the gross lending rate or the gross

rate paid on deposits. The competitive

advantage through tax exemption alone

reflected in the rate structure could be

put in your eye. Removal of the exemption

however, would wipe out the strong feeling

of resentment that exists today because of

the privileged position of Credit Unions

in tax law. It should be removed.





Nethercut & Young

Toronto, Ontario

1 The above is a true and correct copy of the SUBMISSION TO

2  
3  
4 THE ROYAL COMMISSION ON BANKING AND FINANCE

5  
6 BY

7  
8  
9 THE EXECUTIVE COUNCIL

10 OF

11 THE CANADIAN CHAMBER OF COMMERCE

12  
13 300 ST. SACRAMENT STREET

14 MONTREAL, QUEBEC

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1 The Honourable Dana H. Porter,  
2 Chairman, Royal Commission on Banking and Finance,  
3 Ottawa, Ont.

4 Dear Mr. Chairman:

5 I. INTRODUCTION

6 The Executive Council of The Canadian Chamber  
7 of Commerce submits its views on some aspects of Banking  
8 and Finance in Canada. The Chamber agrees fully that  
9 the time is appropriate for a careful and intensive  
10 review of Canada's financial structure. It hopes that  
11 the Commission will be able to recommend changes of  
12 lasting benefit to the Canadian economy.

13 The Canadian Chamber of Commerce is the  
14 national voluntary federation of over 850 community  
15 Boards of Trade and Chambers of Commerce (the terms are  
16 synonymous) throughout Canada.

17 These community Boards and Chambers are  
18 established to promote the civic, commercial, industrial  
19 and agricultural progress of the communities and  
20 districts in which they operate and to promote good  
21 government at all levels: 75% of these community  
22 Boards and Chambers of Commerce serve communities of  
23 less than 5,000 population. Included among the  
24 Canadian Chamber's objectives are the development and  
25 presentation of an informed public opinion and the  
26 securing thereby of effective action by the national  
27 legislature upon questions relating to the economic  
28 and public welfare. The Chamber aims at supporting  
29 and developing the Canadian system of representative  
30 government and the preservation and further improve-  
ment of Canada's economic system based upon private



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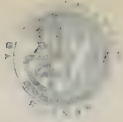
1 initiative and individual enterprise. It also is  
2 concerned with the initiation and promotion of policies  
3 designed to further the more effective use of the  
4 nation's resources of manpower, raw materials, techno-  
5 logical knowledge, production facilities and money.

6 This brief is based upon the democratically  
7 evolved principles and policies of the Canadian Chamber  
8 and is submitted by the Executive Council, which is  
9 appointed by the National Board of Directors, the  
10 governing body of the Chamber, to carry on the ordinary  
11 business of the Chamber during the interim between  
12 meetings of the Board.

## 13 II. PRINCIPLES

14 The broad principles of the Chamber regard-  
15 ing the functioning of Canada's economic system are  
16 well known, having been outlined in detail in its  
17 Policy Declaration on Freedom of Enterprise, adopted  
18 at the annual meeting of the Chamber in October 1961,  
19 and need only briefly be referred to here. Attached  
20 as an Appendix, is a copy of above mentioned Policy  
21 Declaration.

22 The Chamber regards the maintenance of  
23 personal freedom as being of paramount importance,  
24 and feels that wide latitude of consumer's choice,  
25 liberty of the worker in choosing his employment, and  
26 independence of the enterprising spirit are integral  
27 parts of personal freedoms. In addition, the Chamber  
28 believes that in order to make these freedoms mean-  
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1 provided to protect the material standard of living in  
2 the case of individuals who experience loss of income  
3 due to inadvertent misfortune through unemployment,  
4 accident or sickness.

5 The Chamber believes that this kind of in-  
6 dividual well-being will best be achieved within an  
7 economic framework where competitive enterprise is  
8 permitted to make its maximum contribution, and where  
9 government policies are designed to facilitate this  
10 contribution.

11 The Chamber believes that these broad  
12 principles apply as fully to the kind of financial  
13 system or capital market that Canada should strive to  
14 build and preserve as they do to the kind of economy  
15 in general that Canada should hope to enjoy. Indeed,  
16 the Chamber is convinced that free play in the al-  
17 location of the nation's capital -- a primary function  
18 of the capital market -- is a prerequisite for freedom  
19 in business enterprise; for the structure of the  
20 economy will finally be decided by the way savings are  
21 put to use.

22 More specifically, the Executive Council  
23 believes that the economy will best be served by a  
24 capital market that is free, competitive and viable.  
25 It does not believe that the capital market is  
26 functioning perfectly now in every respect; nor, to be  
27 realistic, does it believe that a time will come when  
28 it will function perfectly in every respect. What it  
29 does believe is that the market functions im-  
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1 governmental control of the way the nation's savings  
2 are put to work. The Executive Council believes that  
3 the present deficiencies in the capital market can be  
4 remedied so as to make it function even more efficient-  
5 ly than it does now.

6 The role of government should be one of en-  
7 couraging the system to function more smoothly.

8  
9 III. SUMMARY OF RECOMMENDATIONS

10 There is summarized below the recommendations  
11 which have been made in this Submission:

- 12 1. THAT the role of government be to encourage  
13 the private competitive economic system to  
14 function more smoothly.
- 15 2. THAT co-ordination be developed among various  
16 official fiscal, monetary, debt, and ex-  
17 change policies comprising one overall  
18 economic policy for which the government is  
19 responsible.
- 20 3. THAT the Bank of Canada Act be amended so  
21 as to give the government the authority to  
22 issue broad directives to the Bank of  
23 Canada on overall monetary policy.
- 24 4. THAT there be established an advisory body  
25 of financial people on whom the government  
26 might call for advice on the technical  
27 aspects and effects of the government's  
28 operation in the financial market.
- 29 5. THAT consideration be given to the Bank of  
30 Canada appointing to its staff, on a short





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CONCLUSIONS

which have been made in this Substantiation:

1. THAT the role of government is to encourage  
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2. THAT co-ordination be developed among various  
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4. THAT there be established an advisory body  
 of financial people on whom the government  
 might call for advice on the technical  
 aspects and effects of the government's  
 operation in the financial market.
5. THAT consideration be given to the Bank of  
 Canada appointing to its staff, on a short



1 term basis, a senior executive who has  
2 enjoyed an extended period of experience in  
3 the financial business, outside the Bank of  
4 Canada.

5 6. THAT the government, as well as the central  
6 bank, recruit personnel experienced in the  
7 technical operations of the capital market.

8 7. THAT an effort be made by the Bank of  
9 Canada to inform the public more clearly  
10 about the purposes and capabilities of  
11 monetary policy.

12 8. THAT a fixed central bank rate is desirable  
13 and should be retained.

14 9. THAT the membership of the Board of  
15 Directors of the Bank of Canada be changed  
16 so as to include individuals of long ex-  
17 perience in the operation of the financial  
18 system. To this end, it is suggested that  
19 the composition of the Board should emphasize  
20 competence in financial and economic matters.

21 10. THAT anti-cyclical fiscal policy be followed  
22 which can quickly be reversed, e.g., tax  
23 adjustments rather than changes in govern-  
24 ment expenditures.

25 11. THAT measures to provide a level of material  
26 security to the unemployed are a necessary  
27 part of anti-cyclical economic policy.

28 12. THAT a review be made of the government's  
29 financial institutions to determine what  
30 areas of government operations are adequately



term basis, a senior executive who has enjoyed an extended period of experience in the financial business, outside the Bank of Canada.

6. THAT the Government, as well as the central bank, recruit personnel experienced in the technical operations of the capital market.

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about the purposes and capabilities of monetary policy.

8. THAT a fixed central bank rate in Canadian dollars should be retained.

9. THAT the membership of the Board of Directors of the Bank of Canada be changed so as to include individuals of long experience in the operation of the financial system. To this end, it is suggested that the composition of the Board should emphasize competence in financial and economic matters. THAT anti-cyclical fiscal policy be followed which can quickly be reversed, e.g., tax adjustments rather than changes in government expenditures.

10. THAT measures to provide a level of material security to the unemployed are a necessary part of anti-cyclical economic policy.

11. THAT a review be made of the government financial institutions to determine areas of government operations, as a whole,





- 1 served by private business, and that steps  
2 be taken to eliminate government operations  
3 from those areas.
- 4 13. THAT government financial institutions  
5 should not operate on subsidies but be self-  
6 sustaining, and that these institutions  
7 provide sufficient material in their annual  
8 and other reports to enable the observer to  
9 appraise adequately their operations.
- 10 14. THAT tax exemption for credit unions be  
11 removed.
- 12 15. THAT government explore with the institutions  
13 of the capital market the filling of some  
14 gaps in the capital market by new private  
15 corporations.
- 16 16. THAT there should be more frequent changes  
17 in the prime chartered bank rate and that  
18 the ceiling on interest rates of bank loans  
19 be removed.
- 20 17. THAT recognizing the necessity of raising  
21 risk capital, the commissioners consider  
22 measures to eliminate abuses and unethical  
23 methods in the sale of very risky and highly  
24 speculative stocks.

25 IV. ECONOMIC STABILIZATION POLICIES OF  
26 GOVERNMENT

27 1. Co-ordination of Policies

28 The financial system is directly influenced  
29 by the government's monetary, fiscal, debt and ex-  
30 change rate policies. Co-ordination between those



served by private business, and that steps  
be taken to eliminate government operations  
from those areas.

13. THAT government financial institutions  
should not operate on subsidies but be self-  
sustaining, and that these institutions  
provide sufficient material in their annual  
and other reports to enable the observer to  
appraise accurately their operations.  
14. THAT tax exemption for credit unions be  
removed.

15. THAT government explore with the institutions  
of the capital market the filling of some  
gaps in the capital market by new private  
corporations.

16. THAT there should be more frequent changes  
in the prime chartered bank rate and that  
the ceiling on interest rates of bank loans  
be removed.

17. THAT recognizing the necessity of raising  
risk capital, the commissioners consider  
measures to eliminate abuses and unethical  
methods in the sale of very risky and highly  
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18. ECONOMIC STABILIZATION POLICIES OF  
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1. Co-ordination of Policies

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1 policies is essential. The nation's ability to achieve  
2 the over-all objectives of high level employment,  
3 satisfactory increases in the standard of living, and  
4 reasonable stability of prices will be enhanced if  
5 such co-ordination exists; otherwise it will be jeo-  
6 pardized. Lack of constant co-operation and co-  
7 ordination may lead to policies which create the im-  
8 pression abroad that Canada is unable to manage its  
9 own affairs in a competent manner.

10 To those who would argue that Canada need not  
11 concern itself with the views of other nations, the  
12 Executive Council would reply that our trading and in-  
13 vestment interests demand that Canada's counsel and  
14 credit in international financial and economic circles  
15 be held in respect.

16 It is equally important that Canada should  
17 do nothing which discourages foreign investment, since  
18 it is unlikely we can, for some time, fully finance the  
19 capital development which will be necessary to secure  
20 our national objectives of employment and productivity.

21 Co-ordination between the various official  
22 policies is also necessary from a technical point of  
23 view. It has been obvious over the last several years  
24 that the success of the government's fiscal policy  
25 must ultimately depend on the ability of government to  
26 finance its deficit through the bond market; and its  
27 ability to sell those bonds may depend heavily on the  
28 kind of monetary policy being pursued by the central  
29 bank, as well as its own fiscal policies. On the  
30 other hand, fiscal and monetary policies being pursued





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NORTH AMERICAN  
CONTINENT

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1 will influence the rate of exchange on the Canadian  
2 dollar. Accordingly, the Executive Council believes  
3 that policy co-ordination is essential, and that  
4 separation is futile.

5 For these reasons the Executive Council  
6 believes that the various afore-mentioned policies  
7 should really be regarded as a part of one overall  
8 economic policy and for which the government is un-  
9 mistakably responsible.

10 This matter should be clarified, and the  
11 Executive Council recommends that the Bank of Canada  
12 Act be amended so as to give the government of the day  
13 the authority to issue broad directives to the Bank of  
14 Canada on overall monetary policy when the views of the  
15 government are contrary to the Bank's policy.

16 The Executive Council feels that the position  
17 and prestige of the Bank of Canada must not be under-  
18 mined; but rather it will be enhanced if the public  
19 is assured that the Bank at all times enjoys the  
20 confidence of the elected government.

21 2. Relationships between the Financial  
22 System and the Government's Financial  
Policies

23 Monetary policy is implemented through the  
24 machinery of the capital market; it requires the Bank  
25 of Canada to buy and sell securities -- to operate in  
26 the market. Government fiscal policy also involves  
27 frequent official contact with and operations in the  
28 markets; for example, when there is a cash deficit,  
29 bonds have to be sold. Similarly, the government's  
30 exchange rate policy requires frequent official action



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# Monetary and the Government's Financial Policies

Monetary policy is implemented through the machinery of the capital market; it requires the Bank of Canada to buy and sell securities -- to operate in the market. Government fiscal policy also involves frequent official contact with and operations in the markets; for example, when there is a cash deficit, considerable help may be needed. Similarly, the government's exchange rate policy requires frequent official action





1 in the market.

2 The point to be emphasized is that govern-  
3 ment has become a major force in the day-to-day  
4 operation of the financial markets. It would appear  
5 however that government at times has been insufficiently  
6 aware of the effects of its action on the capital  
7 market. Therefore, the Executive Council believes  
8 that it would be useful for there to be established an  
9 advisory body of financial people on whom the govern-  
10 ment might call for advice on the technical aspects  
11 and effects of the government's operation in the  
12 market. The Executive Council feels that consideration  
13 should also be given to the Bank of Canada appointing  
14 to its staff, on a short term basis, a senior executive  
15 who has enjoyed an extended period of experience in  
16 the financial business outside of the Bank of Canada.

17 In addition, in those key areas of the  
18 machinery of official policy where contact with the  
19 capital market is frequent and important, the Execu-  
20 tive Council would recommend that the government, as  
21 well as the central bank, recruit personnel experienced  
22 in the technical operations of the capital market.

23 The Executive Council feels that economic policy will  
24 be implemented more smoothly and will create fewer  
25 distortions in the functioning of the capital market  
26 if this were done.

### 27 3. Stabilization Policies

#### 28 (a) Monetary Policy

29 The Executive Council believes that  
30 maximum use should be made of the monetary mechanism,



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1 and that a maximum effort should be made to perfect  
2 the implementation of monetary policy. This view is  
3 based on the recognition of the fact that monetary  
4 policy works through and essentially is in harmony  
5 with the operation of a free capital market; and on  
6 the belief that if changes in it are implemented at  
7 the right time and with determination, it will have a  
8 powerful and pervasive effect which is absent from  
9 other stabilization techniques.

10 There is sometimes a tendency on the part  
11 of the public to expect too much from monetary policy.  
12 Disappointment may follow because the judgment of the  
13 central bank's management may have been fallible, or  
14 because public expectations were unrealistic. The  
15 Executive Council recommends that an effort be made by  
16 the Bank of Canada to inform the public more clearly  
17 about the purposes and capabilities of monetary policy.  
18 This would have the advantage of enabling the financial  
19 press to explain policy to a large section of the  
20 general public.

21 As to the effectiveness of monetary policy,  
22 the Executive Council feels that it will be enhanced  
23 by the return to a fixed Central Bank Rate because it  
24 may lead to greater flexibility in "institutional"  
25 interest rates such as the chartered bank loan and  
26 savings deposit rates. The Executive Council has  
27 preferred a fixed Central Bank Rate because it gives  
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29 possible, of the basic trend of central bank policy.  
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2 Canada's weekly statement for signs of a change in policy,  
3 with the result that purely transitory developments  
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6 will encourage public discussion of monetary policy  
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8 dition, it appears likely that in time the somewhat  
9 rigid borrowing and lending rates of banks and other  
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11 the fixed Bank Rate and so will become somewhat less  
12 rigid -- a development which would enhance the effect-  
13 iveness of monetary policy for economic stabilization.  
14 The effectiveness of monetary policy would be enhanced  
15 if it were generally recognized that "tight" money is  
16 intended to "hurt", and if great care were taken to  
17 ensure that it did not cause unjustifiable hardships  
18 in particular sectors of the economy.

19 The Executive Council believes that the  
20 central bank's relations with and operations in the  
21 financial market, as well as the nature of its policy  
22 would be improved if it had as advisers individuals  
23 with long experience in the operation of the financial  
24 system. It recommends therefore that the membership  
25 of the Board of Directors of the Bank of Canada be  
26 changed so as to permit this to occur. The com-  
27 position of the Board should emphasize competence in  
28 financial and economic matters.

29 (b) Fiscal policy

30 The foregoing discussion should not be



Bank of Canada  
Ottawa, Ontario

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(b) Financial Policy

The foregoing discussion should not be





1 interpreted as implying that the Executive Council  
2 places complete reliance on monetary policy, for it  
3 does not do so. It is essential that, due to the  
4 limitations of monetary policy, appropriate fiscal  
5 policies, as well as suitable debt management and ex-  
6 change rate policies be followed.

7 The Executive Council feels that a clear  
8 distinction should be drawn between fiscal policy  
9 designed to deal with the business cycle, and fiscal  
10 policy designed to achieve longer run national ob-  
11 jectives. Any anti-cyclical fiscal policy adopted  
12 should be one which can quickly be reversed. The Ex-  
13 ecutive Council favours tax adjustments rather than  
14 changes in government spending - particularly govern-  
15 ment spending which cannot be reversed quickly and  
16 which does not add to useful social capital.

17 One aspect of desirable fiscal policy  
18 deserves special consideration: this is the effect it  
19 has on business enterprise. The Executive Council  
20 feels that government fiscal policy should be designed  
21 so that it will provide an incentive for economic  
22 growth in the private sector during periods of slack  
23 economic conditions and for restraint during periods  
24 of inflation. The recent budgetary changes relating  
25 to the acceleration of capital cost allowances, tax  
26 concessions relating to sales increases, and the en-  
27 couragement of research expenditures are examples of  
28 such fiscal measures.

29 More can be done, however. Allowances in  
30 addition to the 100% write-off could be used to



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The Executive Council feels that a clear distinction should be drawn between fiscal policy designed to deal with the business cycle, and fiscal policy designed to achieve longer run national objectives. Any anti-cyclical fiscal policy adopted should be one which can quickly be reversed. The changes in government spending - particularly government spending which cannot be reversed quickly and which does not add to useful social capital.

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1 stimulate investment as could the Swedish system of  
2 a tax free investment reserve in business, available  
3 for capital expansion when government declares that  
4 such expansion is desirable.

5 (c) Protection Against Loss of Income

6 It is regarded as inevitable that even  
7 with the most proficient use of monetary and fiscal  
8 policies, there will be times when the economy is not  
9 working at full capacity. Canada's position in inter-  
10 national trade alone suggests that this will be so.  
11 Therefore, there will remain the problem of meeting  
12 the material needs of people who periodically are un-  
13 employed. Those needs, based on our social conscious-  
14 ness, can properly be regarded as the costs of retain-  
15 ing the type of economy we have, and meeting them can  
16 properly be regarded as spreading in an equitable  
17 fashion the costs of retaining that system.

18 For this reason at least the Executive Council  
19 regards measures designed to provide a level of  
20 material security to the unemployed as being a necessary  
21 part of anti-cyclical economic policy.

22 V. GOVERNMENT IN THE BUSINESS OF FINANCE

23 We earlier stated the view that when govern-  
24 ment intervenes in the functioning of the financial  
25 system, it should do so with the objective of im-  
26 proving the functioning of that system and filling  
27 gaps in it that need to be filled and are not being  
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### V. GOVERNMENT IN THE BUSINESS OF FINANCE

We earlier stated the view that when government intervenes in the functioning of the financial system, it should do so with the objective of improving the functioning of that system and filling gaps in it that need to be filled and are not being filled by the private sector. It is the latter which should be the criterion when deciding whether or not should or should not itself establish financial to



1 institutions such as the Industrial Development Bank  
2 or Central Mortgage and Housing Corporation; or whether  
3 or not it should introduce special arrangements such as  
4 guaranteed loans to home owners, farmers, and small  
5 businessmen.

6 It is not the intention of the Executive  
7 Council to review the operations of the government's  
8 financial institutions in order to indicate which ones  
9 are and which are not following that criterion. The  
10 Chamber does, however, recommend that such a review  
11 be made of the government's financial institutions  
12 and that steps be taken to eliminate government oper-  
13 ations in areas which are adequately served by private  
14 business. We wish to make several additional points.

15 First, government financial institutions  
16 should not as a general rule operate indefinitely on  
17 subsidies; they should be self-sustaining. All costs,  
18 including depreciation, taxes and a competitive rate  
19 on funds they borrow, should be taken into account.  
20 The need to fill gaps is not synonymous, in most cases,  
21 with the need to provide subsidies. This would ensure  
22 that if government institutions do in fact impinge on  
23 the areas of the capital market already being served  
24 by private institutions they will at least do so in  
25 a fair and truly competitive manner.

26 Second, government financial institutions  
27 should provide sufficient material in their annual  
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1 judged by sound accounting and economic criteria. Such  
2 information should show whether the institution, in an  
3 economic sense, is successful because it is indeed fill-  
4 ing gaps or because it has found that it can grow more  
5 quickly if it enters into fields already being served  
6 by private institutions. For example, there is a  
7 danger that governmental financial institutions, be-  
8 cause of the natural tendency for officials to want  
9 to see their volume of business grow, will more and more  
10 move into areas beyond the gaps which constitute the  
11 basic justification for their existence.

12 Third, the Executive believes that gaps in  
13 the capital market should in most cases be filled by  
14 new private corporations. For example, the Chamber is  
15 encouraged by the formation of the Export Finance  
16 Corporation of Canada Limited, a private company whose  
17 principal purpose is to provide medium term financing  
18 for exports which are insured by the Government of  
19 Canada's Export Credit Insurance Corporation. Other  
20 more recent examples are the formation of RoyNat  
21 Corporation and The Canadian Enterprise Development  
22 Corporation Ltd., organized by groups of large lending  
23 institutions.

24 Finally, consistent with its opposition to  
25 subsidies for government financial enterprises, the  
26 Executive Council opposes concessions to other  
27 activities such as the exemption of credit unions from  
28 corporations income tax. We see no economic justifi-  
29 cation for such an exemption, particularly now that  
30 credit unions have become big business.



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Third, the Executive believes that gaps in the capital market should in most cases be filled by new private corporations. For example, the Chamber is encouraged by the formation of the Export Finance Corporation of Canada Limited, a private company whose principal purpose is to provide medium term financing for exports which are insured by the Government of Canada. More recent examples are the formation of RoyMac Corporation and The Canadian Enterprise Development Corporation Ltd., organized by groups of large lending institutions.

Finally, consistent with its opposition to subsidies for government financial enterprises, the Executive Council opposes concessions to other activities such as the exemption of credit unions from corporations income tax. We see no economic justification for such an exemption, particularly now that credit unions have become big business.

VI. DEFICIENCIES OF THE CAPITAL MARKET

The Executive Council does not pretend to be able to outline all or even most of the areas where improvements in the capital market may be made. It will refer only to a few which have come to the attention of some of its members. But first it should be made clear that the Executive Council deplores abuses and unethical methods in the sale of very risky and highly speculative stocks; it deplores the fact that the impression which the public has of the financial system is too frequently based on isolated instances of such abuses; and it urges the Commissioners to consider measures which will eliminate them. For a capital market to remain free it must retain the confidence and support of the general public.

The Executive Council feels that the financial system would be improved if competition within the banking system were improved. While there is competition between banks on services provided, it does not extend to the prime loan rate or the savings deposit rate. Increased flexibility in these rates is desirable.

The 6% ceiling on chartered bank loans is an anomaly in a free market and it is recommended that the ceiling be removed. It should be remembered that this might help some borrowers who are not now able to obtain loans, and would enable the banks to pay a higher rate on savings deposits. Also, the 6% ceiling should be really viewed as being "paid for" not by the





# REPORT OF THE FEDERAL RESERVE BOARD

1913

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should be really viewed as being "paid for" not by the



1 banks but by the saver who now obtains a low rate of  
2 interest on his savings account.

3 Further flexibility could be achieved by en-  
4 couraging the banks to become more competitive in their  
5 rate setting. The Executive Council does not believe  
6 that such a policy would produce different rates  
7 between banks -- indeed in a highly competitive situ-  
8 ation one would expect them to be the same -- but what  
9 it might produce is different levels of rates in general  
10 and economically more appropriate timing in the change  
11 of rates. Changes in these rates should more closely  
12 coincide with changes in economic conditions and in  
13 the capital market than has been the case in the past.  
14 Both the business community and monetary policy would  
15 benefit from such increased flexibility.

16 The Executive Council recommends that the  
17 chartered banks' freedom in deciding to whom they should  
18 make loans should not be compromised. At the same  
19 time it feels that periods of tight money restrict small  
20 businesses more than large businesses because the  
21 small businessman frequently has only one outside source  
22 of funds -- his banker. It, therefore, further recom-  
23 mends that the government take steps to ensure that  
24 it has current information on the problem and, if  
25 necessary, introduce measures which will place small  
26 businesses with good credit on an equal footing with  
27 large business during periods of credit restriction.

28 All of which is respectfully submitted.

29 D.L. Morrell F.W. Bradshaw  
30 General Manager Chairman, Executive Council



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The Committee on the Federal Reserve Bank of New York

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Very truly yours,  
Chairman, Committee on the Federal Reserve Bank of New York

Very truly yours,  
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Appendix

FREEDOM OF ENTERPRISE

Canada's Economic System

The Canadian Chamber of Commerce believes in and supports the economic system of competitive enterprise based on individual freedom of choice and personal initiative and responsibility.

The Canadian Chamber of Commerce believes that one of the basic aims of public policy should be the maintenance of personal freedom. In this atmosphere the consumer is free to make his own choice as to how, when or where he will spend his income. These individual choices collectively provide the great stimulating and controlling force governing production. For this force to operate effectively, suppliers of goods and services must be free to compete for these choices, satisfying old ones more economically and searching out new ones promptly. In this competitive atmosphere, only the efficient suppliers of goods and services can prosper. Suppliers who remain inefficient or who continue to produce things no longer wanted will not survive. Through such competition, changes take place and efficiency is increased to the benefit of the consumer. Hence come the phrases "Freedom of Enterprise" and "The System of Competitive Enterprise".

Canada can be great and prosperous only if all individuals have the incentive of adequate reward for risk, energy, initiative and enterprise, along with the right to enjoy the fruits thereof.



Principles of Economics

The Canadian Chamber of Commerce believes in and supports the economic system of competitive enterprise based on individual freedom of choice and personal initiative and responsibility.

one of the basic aims of public policy should be the maintenance of personal freedom. In this atmosphere the consumer is free to make his own choice as to how, when or where he will spend his income. These individual choices collectively provide the great stimulating and controlling force governing production. For this force to operate effectively, suppliers of goods and services must be free to compete for these choices, satisfying old ones more economically and searching out new ones promptly. In this competitive atmosphere, only the efficient suppliers of goods and services can prosper. Suppliers who remain inefficient or who continue to produce things no longer wanted will not survive. Through such competition, changes take place and efficiency is increased to the benefit of the consumer. Hence come the phrases "Freedom of Enterprise" and "The System of Competitive Enterprise". Canada can be great and prosperous only if all individuals have the incentive of adequate rewards for risk, energy, initiative and enterprise, along with the right to enjoy the fruits thereof.



1           The Chamber affirms that the core of its  
2 policy is to support the enterprise system. It believes  
3 that within the freedom concept, limitations on the  
4 freedom of the individual are justified in the interests  
5 of law and order. However, the unwarranted and arbi-  
6 trary exercise of power by governments, often influenced  
7 by collectivist theories, destroys initiative and cur-  
8 tails the dynamic qualities which are essential to the  
9 productive operation of private enterprise.

10           The Chamber recognizes economic education as  
11 the most potent instrument for the extension and  
12 development of the Canadian enterprise system. In  
13 this regard, the Chamber is committed to do all in its  
14 power to help with the enlightenment of the individual  
15 so that he can develop better understanding and act on  
16 his own authority and responsibility.

17           The Chamber recognizes the responsibility of  
18 society to help those individuals incapable of  
19 providing for themselves, but does not believe that it  
20 is the business of the State to provide those services  
21 which the individual can supply for himself. Social  
22 security must not become an end in itself. Canadians  
23 must beware of looking to the State to provide security  
24 to the extent that the individual loses incentive to  
25 provide for himself.

26           If ever business, or the people in general,  
27 come to believe that they can turn to government in  
28 every difficulty, the springs of initiative and self-  
29 reliance will run dry. The Chamber puts its faith in  
30 the responsibility and the resourcefulness of





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If ever business, or the people in general, come to believe that they can turn to government in every difficulty, the springs of initiative and self-reliance will run dry. The Chamber puts its faith in the responsibility and the resourcefulness of



1 individuals operating under the competitive enterprise  
2 system, believing that these factors will ensure the  
3 highest possible standard of living for the whole  
4 Canadian people.

5 RECOMMENDATIONS:

- 6 1. that members of the Chamber promote a greater ap-  
7 preciation of the economic system of competitive  
8 enterprise.
- 9 2. that member Boards and Chambers establish active  
10 Public Affairs Committees with a view to developing  
11 at the local level programs of action with respect  
12 to provincial and national problems.
- 13  
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30



individuals operating under the competitive enterprise  
system, reflecting the fact that the competitive  
system is a system of giving the individual  
individual freedom.

CONCLUSIONS

1. that members of the Chamber promote a greater ap-  
preciation of the economic system of competitive  
enterprise.
2. that member Boards and Chambers establish active  
Public Affairs Committees with a view to developing  
at the local level programs of action with respect  
to provincial and national problems.



# Royal Commission on Banking and Finance

CANADIAN LABOUR CONGRESS

Hearings  
held at  
OTTAWA

Vol. 52 Date. 24 OCT 1962



Official Reporters  
J. J. Nethercut and R. J. Young  
Toronto, Ont.





ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,  
Ontario, on Wednesday,  
October 24th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter  
Chief Justice of Ontario  
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.  
Investment Dealer  
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.  
Banker  
Toronto, Ontario

Mr. Gordon L. Harrold  
Agriculturalist  
Calgary, Alberta

Mr. Paul H. Leman  
Corporation Executive  
Montreal, Quebec

Mr. John C. MacKeen  
Corporation Executive  
Halifax, Nova Scotia

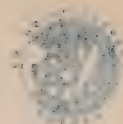
Dr. W. A. Mackintosh  
Vice-Chancellor  
Queen's University  
Kingston, Ontario

-----

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary





ROYAL CANADIAN MOUNTED POLICE

ALBANY, N.Y.

Hearings held at Ottawa,  
Ontario, on Wednesday,  
October 24th, 1905.

THE WITNESSES

The Honorable James Laurier, Minister  
of the Interior, Ottawa, Ontario.

Mr. W. Thomas Brown, M.P.E.  
Investment Dealer  
Montreal, Quebec.

Mr. James Douglas Gibson, O.B.E.  
Banker  
Toronto, Ontario.

Mr. Gordon L. Macdonald  
Regimental Surgeon  
Calgary, Alberta.

Mr. Paul H. Leman  
Corporation Executive  
Montreal, Quebec.

Mr. John A. Macdonald  
Commissioner of the  
Halifax, Nova Scotia.

Dr. W. A. Macdonald  
Vice-Chancellor  
Queen's University  
Kingston, Ontario.

Mr. J. A. Macdonald - Secretary  
Mr. John Macdonald - Joint Secretary



Ottawa, Ontario  
Wednesday,  
October 24th, 1962

--- At 9.20 A.M. the hearing commenced.

SUBMISSION OF  
CANADIAN LABOUR CONGRESS

-----  
APPEARANCES

Mr. Donald MacDonald - Secretary-Treasurer  
Canadian Labour Congress  
Mr. Russell Bell - Acting Research Director  
Canadian Labour Congress  
-----

THE CHAIRMAN: We will now consider the brief of the Canadian Labour Congress. We have all read this brief with considerable care and we are very much impressed with the amount of work and thought that has gone into it and wish to congratulate you on the brief that you have presented.

As you understand, it is not necessary to read the summary unless you so desire; having read the brief generally we proceed with questions and enter into a discussion on various aspects of the points that you have raised. Is that satisfactory to you?

MR. MacDONALD: Yes.

THE CHAIRMAN: We will now proceed.

MR. MacDONALD: My Lord Chief Justice and members of the Commission, I should perhaps first of



Ottawa, Ontario

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SUBMISSION OF

CANADIAN LABOUR CONGRESS

APPENDIX

Mr. Donald MacDonald - Secretary-Treasurer  
Canadian Labour Congress

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Canadian Labour Congress

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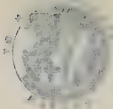




1 all say on behalf of the Canadian Labour Congress, as  
2 one of the bodies who requested the establishment of  
3 your Commission, that we welcome this opportunity to  
4 appear before you and present our views.

5 As we have indicated in the opening para-  
6 graph of our submission, we believe that the operations  
7 of the monetary and financial institutions of this  
8 country have an important bearing on two matters with  
9 which we are very much preoccupied at the moment and  
10 which cause great concern; namely, unemployment and  
11 economic growth. That is, you have no doubt noted  
12 from your perusal of the document that we have laid  
13 great emphasis on these aspects of our submission.

14 I perhaps at this point should also express  
15 my regrets that for the reasons set forth in our  
16 official submission it is not possible for us to be  
17 as helpful as we would have otherwise liked to be with  
18 respect to some particular matters about which you  
19 have inquired, such as the activities of unions as  
20 borrowers and lenders in the capital market, and  
21 the information which you indicated was desirable with  
22 regard to pensions operated on behalf of workers.  
23 We would have liked to have provided the desired  
24 information, but, as we have explained, it is not  
25 possible within our structure to obtain it as easily  
26 as might be assumed. However, we have tried to the  
27 best of our ability to set forth, as was indicated  
28 was desirable, our basic philosophy with regard to  
29 the central questions facing the Commission and, as  
30 you have already indicated, My Lord Justice, we are



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1 relieved to find that we are not expected to read  
2 the entire submission or even the summary, and we take  
3 it for granted that what will be done is questioning  
4 with regard to matters that are contained in the  
5 submission itself.

6 I am not an economist and certainly would  
7 not wish to have any misunderstanding with regard to  
8 my qualifications; therefore, any technical or economic  
9 questions that arise will be dealt with by our acting  
10 director of research, Mr. Russell Bell, who is here  
11 with me, and I will, of course, endeavour to deal with  
12 any matters of basic policy or structure or function  
13 of the labour movement in general or the Canadian  
14 Labour Congress in particular.

15 I think that is all we want to say at the  
16 moment, My Lord Justice and gentlemen, and as far  
17 as we are concerned we are prepared to receive and  
18 try to cope with any questions that might arise from  
19 your perusal of our submission.

20 THE CHAIRMAN: Thank you very much.

21 COMMISSIONER LEMAN: Mr. Chairman, before  
22 we get into the part of the discussion dealing with  
23 the views expressed in your brief, could I ask you  
24 very briefly to tell us what are the main functions  
25 of the C.L.C. as such?

26 MR. MacDONALD: Yes, I think this would  
27 be helpful and questions of this kind will place  
28 our position in better perspective, perhaps.

29 The Canadian Labour Congress is a national  
30 labour centre. It is not a union in itself, it is a



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MR. MACDONALD: Yes, I think this would

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our position in better perspective, perhaps.

The Canadian Labour Congress is a national  
labour centre. It is not a union in itself, it is a



1 federation of unions who banded together on a voluntary  
2 basis and the Congress' main functions are that of  
3 a co-ordinating and legislative body at the national  
4 level, although it does interest itself and is active  
5 in practically all activities that come within the  
6 scope of labour, and today that is pretty broad.

7 That is an extremely brief statement of  
8 our position, but if you wish me to amplify it, I would.  
9 We have a million and 70 thousand members and approxi-  
10 mately 116 affiliated national and international unions,  
11 others of which are regional and provincial, and with  
12 some 20 odd thousand in unions which are directly  
13 chartered by the Congress itself.

14 We operate throughout the country and we  
15 have established ourselves I think in almost every  
16 nook and cranny of Canada and we maintain five regions  
17 throughout the entire nation with staffs and headquarters  
18 in each of these regions and conduct our organizational  
19 and educational work largely from these regional  
20 operations.

21 We are also extremely active -- I don't  
22 know if this is of interest to the Commission, but  
23 perhaps it should be mentioned in passing -- we are  
24 also extremely active at the world level; we are one  
25 of the founding members of our world-wide body, the  
26 International Federation of Free Trade Unions, and  
27 participate very actively in this work.

28 I don't know if there is anything more I  
29 could add usefully at the moment, and if this gives  
30



federation of unions who banded together on a voluntary basis and the Congress. Main functions are that of a co-ordinating and legislative body at the national level, although it does increase itself and is active in practically all activities that come within the scope of labour, and today that is pretty broad.

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I don't know if there is anything more I could add usefully at the moment, and if this gives





1 rise to any further questions I would be delighted  
2 to try and answer them, of course.

3 COMMISSIONER LEMAN: You say in your brief  
4 that there are a few areas where you don't have certain  
5 statistics that the Commission have asked for; these  
6 are not, perhaps, statistics which you regularly assemble  
7 and therefore they were not available, but does the  
8 Congress, does the Research Department of the Congress  
9 gather statistics of its own or just work with the  
10 available published statistics from D.B.S. and other  
11 sources, or do you assemble statistics of your own?

12 MR. MacDONALD: We do both. Do you wish  
13 to answer that?

14 MR. BELL: Yes, we do both, as our secretary-  
15 treasurer has just said. On the one hand we, of  
16 course, use very directly the official statistics  
17 put out by the government, the D.B.S. statistics and,  
18 of course, we have access to statistics put out by  
19 other governments agencies, and so on, but in addition  
20 to that we also collect statistics with regard to matters  
21 of a collective bargaining nature and our Research  
22 Department supplies information with respect to  
23 collective bargaining statistics, and the various  
24 unions that are interested in such are getting such  
25 data.

26 COMMISSIONER LEMAN: Now, in another field,  
27 what are what you call the areas of authority of the  
28 Congress over the member unions?

29 MR. MacDONALD: I suppose that would hinge  
30 on the definition of "authority", but actually we are

100-100000

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COMMISSIONER LEMAY: You say in your letter

that there are a few areas where you don't have certain

statistics for the Department of the Interior?

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MR. McDONALD: I suppose that would hinge

on the definition of "authority", but normally we are



1 composed almost exclusively of autonomous affiliates;  
2 about 70 per cent of our membership and roughly the  
3 same percentage of our affiliate unions are international  
4 in character, operating in both the United States and  
5 Canada, and the vast majority of the others are national.

6 Each of these autonomous affiliates conduct  
7 their own affairs and their affiliation with the C.L.C.  
8 is on a purely voluntary basis. However, we do  
9 naturally require the affiliates and the members  
10 to support the constitution of the organization  
11 of which they are a part and to subscribe to the  
12 principles and policies, and where they do not do so,  
13 of course -- like all other democratic organizations --  
14 we naturally have to enforce such discipline as in  
15 the opinion of our convention is warranted.

16 COMMISSIONER LEMAN: But so long as they  
17 want to remain members they can, but they also can  
18 withdraw if they want to?

19 MR. MacDONALD: Yes.

20 COMMISSIONER LEMAN: As long as they want  
21 to remain members, very broadly, what sort of things  
22 do they have to agree to? Is it in economic matters,  
23 for instance? Is there anything of an economic nature?

24 MR. MacDONALD: Not with respect to  
25 collective bargaining; collective bargaining as such  
26 is purely within the jurisdiction of the individual  
27 unions. We do, however, make our economic position  
28 known through our convention, through democratic action,  
29 and our economic views are assumed -- because of the  
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and our economic views are assumed -- because of the



1 manner in which they are adopted and approved -- they  
2 are assumed to reflect that of all our membership and  
3 all our affiliates unless we have some indication to  
4 the contrary, which has never been the case.

5 COMMISSIONER LEMAN: Well now, would you  
6 restate for us, Mr. MacDonald, the very broad stand  
7 which you take on what are the objectives of economic  
8 policy that the Congress supports?

9 MR. MacDONALD: I think that Mr. Bell is  
10 much better qualified to deal with that than I am.

11 MR. BELL: The general economic objectives  
12 of the Canadian Labour Congress, is that the question,  
13 sir?

14 COMMISSIONER LEMAN: Yes. I wouldn't say  
15 it is the objectives of the Canadian Labour Congress;  
16 it is the economic objectives which the Congress feels  
17 are the right ones for the country to pursue.

18 MR. BELL: At our last convention the  
19 Canadian Labour Congress adopted a statement on  
20 economic policy, and this particular statement set  
21 out as the main goal, the main economic goal or  
22 objective of the Congress, as being full employment.  
23 This has been our primary interest, as you would naturally  
24 expect, and we have consequently tried to formulate  
25 what is in our opinion appropriate policies to achieve  
26 this goal of full employment.

27 COMMISSIONER LEMAN: That is the primary  
28 one. Are there secondary ones, too, which you feel  
29 go along with this.

30 MR. BELL: Yes. I was going to add, sir,



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1 that while we advocate as our primary goal, full  
2 employment, at the same time we are advocating measures  
3 to bring about that primary goal and we are also con-  
4 cerned that such measures should also lead to stability,  
5 to economic stability.

6 We are concerned with the whole subject  
7 of price, of course, and consequently we have tried  
8 to formulate policies that would bring about full  
9 employment with the maximum price stability.

10 COMMISSIONER LEMAN: Well now, do you  
11 believe that you could put some kind of quantitative  
12 measures on what you call full employment and reasonable  
13 price stability, the best possible price stability  
14 and growth of the economy. Do you think you could  
15 put figures on what you would think are satisfactory  
16 achievements in those fields?

17 MR. BELL: Well, as far as full employment  
18 is concerned, we have generally taken the position  
19 that if we have no more than 3 per cent of the labour  
20 force unemployed, then we have virtually full employ-  
21 ment.

22 COMMISSIONER LEMAN: Could you elaborate  
23 on that a little bit? You use that figure of 3 per  
24 cent; is that because of the nature of that index?

25 MR. BELL: The 3 per cent figure has to  
26 be an arbitrary one, as you appreciate but, on the  
27 basis of our information and knowledge, we have  
28 assumed that given the kind of circumstances, the  
29 economic circumstances that prevail in this country --  
30 the economic and social circumstances, I should say --



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COMMISSIONER IRMAN: Well now, do you believe that you could put some kind of quantitative measures on what you call full employment and reasonable price stability, the best possible price stability and growth of the economy. Do you think you could put figures on what you would think are satisfactory achievements in those fields?

MR. BELM: Well, as far as full employment is concerned, we have generally taken the position that if we have no more than 3 per cent of the labour force unemployed, then we have virtually full employment.

COMMISSIONER IRMAN: Could you elaborate on that a little bit? You use that figure of 3 per cent; is that because of the nature of that index? MR. BELM: The 3 per cent figure has to be an arbitrary one, as you appreciate but, on the basis of our information and knowledge, we have assumed that given the kind of circumstances, the economic circumstances that prevail in this country -- the economic and social circumstances, I should say --



1 that 3 per cent or less of the labour force unemployed  
2 would virtually amount to full employment.

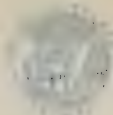
3 There is, of course, a certain amount  
4 of frictional unemployment that takes place in a  
5 country, and particularly in a country like this,  
6 and consequently some allowance has to be made for  
7 that, and I think that if one makes this kind of  
8 an allowance that the 3 per cent figure is not an  
9 unreasonable one.

10 Perhaps you would like me to briefly  
11 elaborate on what we mean by frictional unemployment?

12 COMMISSIONER LEMAN: We have had repre-  
13 sentations made on that. I was wondering if you  
14 would go so far as to say, however, that if you should  
15 go beyond 3 per cent unemployment -- in other words,  
16 2 per cent or one per cent -- you have passed what  
17 you would call the full employment base, and then  
18 you begin to have trouble with the other objectives which  
19 you want to pursue.

20 MR. BELL: Well this, of course, depends  
21 on the economic circumstances. We had for quite  
22 a number of years, as you are undoubtedly aware, in  
23 the earlier post-war years this less than 3 per cent  
24 labour force unemployment. As a matter of fact, the  
25 percentage of unemployment has been quite a bit less  
26 at certain times, less than 3 per cent. Of course,  
27 there were certain conditions that gave rise during  
28 that period to full employment and I am sure that you  
29 do not want me to go into all of the reasons why we  
30 had full employment during the earlier post-war years





would virtually amount to full employment.

of frictional unemployment that takes place in a country, and particularly in a country like this, and consequently some allowance has to be made for that, and I think that it was this kind of an allowance that the 3 per cent figure is not an

Perhaps you would like me to briefly elaborate on what we mean by frictional unemployment? COMMISSIONER LEMAN: We have had repre-

sentations made on that. I was wondering if you would go so far as to say, however, that if you should go beyond 3 per cent unemployment -- in other words, 2 per cent or one per cent -- you have caused what you would call the full employment zone, and then you begin to have trouble with the other objectives which you want to pursue.

MR. BELL: Well this, of course, depends on the economic circumstances. We had for quite a number of years, as you are undoubtedly aware, in the earlier post-war years that less than 3 per cent labor force unemployment. As a matter of fact, the percentage of unemployment has been quite a bit less at certain times, less than 3 per cent. Of course, there were certain conditions that have risen during that period to full employment and I am sure that you do not want me to go into all of the reasons why we



1 because I am sure you are fully acquainted with those  
2 reasons and I am sure that those reasons have been  
3 discussed before your Commission previous to our  
4 attendance here.

5 COMMISSIONER LEMAN: What I was driving  
6 at was this; you believe, for instance, that 3 per  
7 cent in Canada represents a full employment position  
8 and that the moment you exceed that it will have a  
9 direct effect, for instance, on the pressure on prices?

10  
11 MR. BELL: Well this, of course, is  
12 very difficult to say.

13 COMMISSIONER LEMAN: It has a direct  
14 relationship?

15 MR. BELL: Yes, because what you are  
16 hinting at -- if I might put it this way -- once you  
17 get below the 3 per cent level then you are getting  
18 into what some economists call over-full employment.

19 Now, where or just at what stage this so-  
20 called condition of over-full employment is attained  
21 is exceedingly difficult to say. Conceivably, if you  
22 have the entire labour force employed, if you had  
23 no unemployment whatsoever, that this presumably would  
24 indicate a state of over-full employment because it  
25 wouldn't take into consideration the normal frictional  
26 unemployment.

27 COMMISSIONER LEMAN: What I am thinking  
28 about is that when you have separate objectives these  
29 have to be kept in balance, you say, and I am wondering  
30 how you believe that this balance works in practice?

because I am sure you are fully acquainted with those reasons and I am sure that those reasons have been

attendance here.

COMMISSIONER LEWIS: What I was saying

at was this: you believe, for instance, that 3 per

cent in Canada represents a full employment position

and that the moment you exceed that it will have a

direct effect, for instance, on the pressure on prices?

MR. BELL: Well, of course, it

very difficult to say.

COMMISSIONER LEWIS: It has a direct

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MR. BELL: Yes, because when you are

standing at -- if I might put it this way -- once you

get below the 3 per cent level when you are getting

into what some economists call over-full employment.

Now, where or just at what stage does so-

called condition of over-full employment is attained

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have the entire labor force employed, if you had

no unemployment whatsoever, what this necessarily would

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wouldn't take into consideration the normal frictional

COMMISSIONER LEWIS: What I am thinking

about is that when you have resources themselves there

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how you believe that this balance works in practice?





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1 MR. BELL: Well, I would just like to  
2 make this point, sir. As you are probably well aware,  
3 there has been a considerable amount of controversy  
4 over the past few years on the subject of whether  
5 or not you can have full employment accompanied by  
6 price stability.



MR. BELL: Well, I would just like to

ask this of you, sir. As you are probably well aware,

there has been a considerable amount of discussion

in the past few years on the subject of whether

or not you can have full employment accompanied by

low prices.



1 This argument has been in full force in the United  
2 States, I think in particular, for the past few  
3 years. It has been the subject of very considerable  
4 controversy, and it is a controversy, of course,  
5 which has not been settled by economists, such as  
6 many other controversies. We have taken the position,  
7 though, that if it is not possible to have, say,  
8 complete price stability and at the same time full  
9 employment, then our priority would be given to the  
10 full employment.

11 I am not suggesting that it is not possible  
12 to have complete price stability and, at the same time,  
13 full employment. Quite frankly this is an exceedingly  
14 difficult question to answer. I do not think anybody,  
15 really, is in a position to answer this, but if price  
16 stability and full employment are not mutually  
17 attainable, then we would certainly give preference  
18 to full employment. This is a position which has  
19 been taken by many European governments and their  
20 economists. As you are probably aware, price increases  
21 have been much more considerable in Europe, particularly  
22 in the last few years, than here in Canada and the  
23 United States. As a matter of fact, both in Canada  
24 and the United States during the last few years we  
25 have had virtual price stability. It is quite true  
26 that there have been some upward rises to the consumer  
27 price index but I personally take the position that  
28 if you have a small rise in the consumer price index,  
29 for example, that this does not necessarily indicate  
30 a state of inflation because there are certain upward





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if you have a small rise in the consumer price index,

for example, that this does not necessarily indicate

a state of inflation because there are certain upward



1 biases in the consumer price index. I am sure this  
2 has been discussed before your Commission on previous  
3 occasions. One, of course, is in connection with the  
4 increased quality of goods and services. Consequently,  
5 a slight rise in the consumer price index, the kind  
6 of rise we have been having over the past few years,  
7 may simply reflect that improvement in the quality  
8 of goods and services. If that is the case, I do not  
9 think you could call that inflation.

10 COMMISSIONER LEMAN: And this moderate price  
11 increase at the consumer goods level, you feel, is  
12 in terms of what percentage-wise, an acceptable rise  
13 which would not spell inflation, one per cent, two  
14 per cent or what?

15 MR. BELL: Yes, I would say one or two per  
16 cent would not indicate a state of inflation. Perhaps  
17 if the consumer price index went up two per cent it  
18 would indicate a slight inflationary tendency in the  
19 economy, but if we could experience full employment  
20 conditions with that condition, this would not be a  
21 matter of great concern.

22 COMMISSIONER MACKINTOSH: May I interject  
23 a question at this point?

24 COMMISSIONER LEMAN: Certainly.

25 COMMISSIONER MACKINTOSH: I take it from what  
26 you say, Mr. Bell, you recognize this full employment  
27 measurement, which you say is a very great simplification,  
28 and that you would have to understand what was behind,  
29 say, the three per cent. You may have a national three  
30 per cent which includes, we will say, an unfortunately







1 heavy rate of unemployment in the Nova Scotia coal  
2 mines and also in the British Columbia lumber industry,  
3 arising out of particular problems affecting those  
4 industries, in which case I take it you would agree  
5 that the remedy was not to try and raise aggregate  
6 demand further but rather to go to work on the Nova  
7 Scotia and the B.C. problems to see what you could  
8 do with those industries so that you may have an even  
9 three per cent which represents over-employment in  
10 some regions, in the sense that the proper approach  
11 to it is not one of stimulating further aggregate  
12 demand. Would you agree substantially with that  
13 statement?

14 MR. BELL: Yes. When we were discussing  
15 the three per cent, of course, we were thinking in  
16 terms of a national average and consequently it would  
17 be necessary to take into account regional unemployment  
18 problems. As a matter of fact, if you had only three  
19 or possibly even four per cent of the labour force  
20 unemployed and it could be demonstrated that the  
21 principal contributing factor there was regional  
22 unemployment such as the kind you have just suggested,  
23 then the measures required to deal with that situation  
24 undoubtedly would be quite different from the measures  
25 required to deal with an over-all unemployment problem.

26 COMMISSIONER MACKINTOSH: I am not arguing  
27 against your proposition. I am just suggesting this  
28 to make it more realistic.

29 MR. BELL: Quite true.

30 COMMISSIONER MACKINTOSH: To get it a little



Mr. Mackintosh

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Mr. Mackintosh: Yes, I agree.

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COMMISSIONER MACKINTOSH: I am not arguing  
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to make it more realistic.

COMMISSIONER MACKINTOSH: To get it a little



1 out of the diagram and into reality.

2 COMMISSIONER LEMAN: One could put on a  
3 graph a few curves and see some correlations which  
4 might be just coincidence instead of cause and effect.  
5 You say that for the last four or five years we have  
6 had what you consider a reasonable price stability  
7 in Canada. Prior to that we had had a fairly constant  
8 price increase for a few years, had we not?

9 MR. BELL: Yes. I would just say for the  
10 purpose of being as specific as possible that we have  
11 not had, in my opinion, what you would call any  
12 significant inflation since 1957. As you are undoubtedly  
13 aware, the last period of what I would call significant  
14 inflation took place during the period 1955 up to 1957.  
15 That particular inflation was really an investment  
16 inflation precipitated by corporations that were  
17 expanding their plant production capacity at a very  
18 fast rate. This was the main reason why we had  
19 inflation at that time, but since then I do not think  
20 it would be accurate to describe us as experiencing  
21 any significant inflationary pressures.

22 COMMISSIONER LEMAN: In practice the  
23 views of the Congress on these economic objectives  
24 and how to achieve them and how to maintain a reasonable  
25 balance -- how does this work down to your members  
26 when they formulate their own objectives in terms of  
27 wage policies for their own members? In other words,  
28 is there any consideration given or is there guidance  
29 given by the Congress to the members in terms of  
30 national objectives when they formulate their policies?



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1 MR. MacDONALD: Only in the sense, as I  
2 explained before, that when the economic policy of  
3 the Congress is adopted it is adopted in convention  
4 with representation from all our affiliates, and it  
5 is supposed to serve as a guide to them and certainly  
6 to be given due consideration. However, as I also  
7 explained, they are completely autonomous and we do  
8 not have any authority or any control over any of our  
9 affiliates with respect to their collective bargaining  
10 policies. In this our nation is different from at  
11 least some others that one can think of. Conditions  
12 vary so greatly within regions and within industries  
13 that under existing conditions it would be utterly  
14 impossible, I think, as is evidenced, to achieve any  
15 degree of uniformity or standardization with regard  
16 to collective bargaining objectives. There are, as  
17 all of us know, certain countries where that desirable  
18 objective has been obtained, but our circumstances  
19 here would not permit it.

20 COMMISSIONER LEMAN: What I am thinking of  
21 is this. Do you believe there can be some relation-  
22 ship between wage policy and employment; in other  
23 words, may one have an effect on the other? If there  
24 is too fast a rate of increase in average wage  
25 levels can that have a bad effect on employment?

26 MR. BELL: Could I just counter that, sir,  
27 by asking you what you mean by too rapid a rise in  
28 wage levels?

29 COMMISSIONER LEMAN: No, I will let you use  
30 your own definition of that.



MR. MacDONALD: Only in the sense, as I

explained before, that when the economic policy of

the Government is in conflict with the

with representation from all our affiliates, and it

is supposed to serve as a guide to them and certainly

to be given due consideration. However, as I also

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COMMISSIONER LEVINE: What I am thinking of

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ship between wage policy and employment; in other

words, may one have an effect on the other? If there

is too fast a rate of increase in average wage

levels can that have a bad effect on employment?

MR. MacDONALD: I think I have already indicated

by asking you what you mean by too rapid a rise in

wage levels?

COMMISSIONER LEVINE: No, I will let you use

your own definition.





1 MR. BELL: Well, of course, the conventional  
2 argument is, as I am sure you are well aware, that if  
3 wage rates rise more rapidly than productivity increases,  
4 that this is a contributing factor to inflation, and  
5 so on. From all the available evidence we have not  
6 found that, -- I am sure this is what you wanted me  
7 to get around to, sir, and perhaps I am going a little  
8 too far afield but just stop me if I am -- from all  
9 the available evidence we have we have not found  
10 that wage increases have been too rapid in Canada.  
11 We have not found that wage increases have been a  
12 contributing factor to inflation. As a matter of fact,  
13 the last few years indicate perhaps even the contrary,  
14 for wage increases, that is annual average wage  
15 increases, in this country in the past several years  
16 have actually been going down rather than up. I am  
17 talking about average annual earnings increases. These  
18 have been going down over the past several years.  
19 I do not know whether this answers the question properly  
20 or not.

21 COMMISSIONER LEMAN: You are talking about  
22 the amount of wages divided by all the people in the  
23 country, or all the workers?

24 MR. BELL: Yes, I am talking about average  
25 annual increases in wages. I am speaking on a national  
26 basis now.

27 COMMISSIONER LEMAN: For those who are  
28 working or for all the population?

29 MR. BELL: No, for those who are employed  
30 in industry.



MR. BELLE: Well, of course, the conventional

is, as I am sure you are well aware, that if

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COMMISSIONER LEWIS: Now those who are

working or for all the population?

MR. BELLE: No, for those who are employed



1 COMMISSIONER LEMAN: So, the rate of increase  
2 has gone down?

3 MR. BELL: The rate of increase per year,  
4 precisely.

5 COMMISSIONER LEMAN: And when did the curve  
6 turn? What year did this begin to flatten out?

7 MR. BELL: I am sorry. I have not got  
8 the figures with me but this occurred in 1961, in 1960,  
9 and in 1959. I am speaking now from memory only, so  
10 I can be subject to correction. But if I am not  
11 mistaken the average annual increase in earnings in  
12 Canada in 1959, for example, was about 3.6 per cent.  
13 Then in 1960 I think this was 3.5 per cent, and in  
14 1961 I believe it had actually dropped to 2.8 per cent.  
15 As I said before, those figures I am giving from  
16 memory.

17 COMMISSIONER LEMAN: Since you have a  
18 quantitative objective in terms of reasonable price  
19 stability in terms of, say, one or two per cent per  
20 year, not being really inflation, etc., would you  
21 have a quantitative objective for wage increases too?  
22 What would be the satisfactory rate of increase per  
23 year, to keep the objectives in balance still?  
24 I want to keep concentrating on this equilibrium  
25 between objectives, you see.

26 MR. BELL: I think I would answer that  
27 question by saying we have not any evidence, for  
28 example, that average annual earnings increases have  
29 been exceeding productivity increases. It is quite  
30 true that productivity data are extremely difficult to





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been exceeding productivity increases. It is quite

true that productivity has been extremely difficult to



1     come by in Canada. There are no real official  
2     productivity data published by the Dominion Bureau  
3     of Statistics, as is the case in other countries  
4     such as the United States, but on the basis of  
5     unofficial data that have been produced it would seem  
6     to indicate that wage increases have not been out-stripping  
7     productivity increases, as is commonly charged.

8             COMMISSIONER LEMAN: I understand that and  
9     I am not disputing it at all. What I am wondering  
10    is whether you think a certain rate of increase in  
11    both productivity and wage increases is attainable  
12    here. Do you believe it is attainable on average?  
13    I am not talking about this year but as a long-run  
14    view.

15            MR. BELL: I will have to come back to  
16    what our Secretary-Treasury, Mr. MacDonald, has just  
17    told you, that it is difficult to formulate objectives  
18    simply because of the structure of our trade union  
19    movement. A given union, for example, negotiates  
20    for a wage increase or improvements in working  
21    conditions in accordance with what it believes is  
22    feasible or practicable within its industry, and of  
23    course this goes on right across the board.

24            Now, what one union thinks is a reasonable  
25    objective may differ considerably from what another  
26    union thinks is a reasonable objective, simply  
27    because of the different conditions that obtain in  
28    the different industries. So, consequently, it would  
29    be very, very difficult to formulate a national  
30    objective with regard to increases, that is one that



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1 would have any real meaning.

2 COMMISSIONER LEMAN: Considering that your  
3 members are autonomous how do you think they view  
4 these things when they set their own goals? Do they  
5 think in terms of wage increases for the members who  
6 are working and are members of the union, all by  
7 themselves in isolation, or do they make some kinds  
8 of correlation, do you think, in setting their own  
9 policy between what could be the effect of a certain  
10 rate of increase in that particular industry and its  
11 effect on future prospects of employment in that industry?  
12 Do you think they pay any attention to these things?

13 MR. MacDONALD: I do not believe any general  
14 answer can be given to that question. There are some  
15 of our unions that are quite large and employ very  
16 competent technical staff whose advice and information,  
17 of course, is available to them.



THE UNITED STATES DEPARTMENT OF LABOR

WASHINGTON, D. C.

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answer can be given to that question. There are some

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1 I think in those instances those particular unions  
2 would have regard to all aspects of all economic  
3 situations both in relation to their own particular  
4 industries and that of the national level. In those  
5 instance, of course, we have very, very small unions  
6 as well, and I think there they would not have  
7 available to them as expert information as would be  
8 the case in respect of the larger ones and, of course,  
9 this situation can vary as well.

10 In some instances some of our small unions  
11 will turn to us and ask us for information and  
12 data which will, of course, be provided through the  
13 medium of our research department and our economists,  
14 and other unions will not. So, really within the  
15 framework of our structure it is almost impossible  
16 to give one general answer to the question.

17 COMMISSIONER MACKINTOSH: May I ask if in  
18 relation to these smaller unions in addition to  
19 furnishing them with consumer price indices and  
20 various other statistical information whether the  
21 Congress would also supply advice in respect of  
22 collective bargaining objectives in the particular  
23 setting of the time at which they are asking, or is  
24 that service restricted simply to the medium of a  
25 formal request?

26 MR. MacDONALD: It would be restricted to  
27 the medium of formal request. We would not gratuitously  
28 provide advice to them with regard to their collective  
29 bargaining objectives unless it was desired by them.

30 COMMISSIONER MACKINTOSH: Do they in fact



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formal request?

MR. McDONALD: It would be restricted to

the medium of formal request. We would not gratuitously  
provide advice to them with regard to their collective  
bargaining objectives unless it was desired by them.  
COMMISSIONER MARKS: Do they in fact



1 sometimes ask for that?

2 MR. MacDONALD: I would say infrequently.

3 COMMISSIONER LEMAN: Well, I realize how  
4 difficult it would be to get too precise with regard  
5 to any particular union bargaining for wages in a  
6 particular industry. I think it would be taking a  
7 great responsibility to tell them: well now, we think  
8 you should restrict your demands to just so much,  
9 because it will have certain effects, and it is very  
10 difficult to predict exactly what the effects would be,  
11 but in the Congress itself when you have conventions,  
12 when you get together -- once a year, is it?

13 MR. MacDONALD: No, biannually; every  
14 two years.

15 COMMISSIONER LEMAN: Are those things  
16 talked about in terms of general national goals?

17 MR. MacDONALD: Oh, yes and, of course,  
18 in addition to our convention, and perhaps I should  
19 have elaborated previously, we have an executive  
20 council which is our policy body during the period  
21 between conventions which meets frequently -- well,  
22 I should say four times a year on the average-- and  
23 such things are discussed, of course. There is an  
24 exchange of views between the various unions and  
25 groupings represented on the executive council.

26 COMMISSIONER LEMAN: Well, now, I have a  
27 question in respect of what you believe in a period  
28 of high demand. Let us talk again in terms of pre-  
29 1957 and post-1957. Lets take a period of very high  
30 demand where perhaps the result achieved in terms of

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MR. McDONALD: I would say infrequently.

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1977 and post-1977. Let us take a period of very high

demand where perhaps the result achieved in terms of





1 employment was not so much a matter of policy but  
2 as the result of the fact that we were in a period of  
3 high demand, and without having any particular employment  
4 policy you just had a very high rate of employment.

5 In a situation like that what do you think is the  
6 relevant weight of union action in getting higher  
7 wages for the members as against just the general  
8 atmosphere of high demand? What do you think produces,  
9 or has produced the increase in the level of wages?  
10 What proportion of it was due to action by unions  
11 and what proportion of it was due just to the economic  
12 atmosphere in which people were bargaining and working?

13 MR. BELL: I think, sir, that one would  
14 have to take a given period and examine that period.  
15 You referred to the pre-1957 period. Well, I think  
16 perhaps the first two years, as a matter of fact,  
17 just prior to that; the latter part of 1955 up to  
18 approximately the end of 1956 is a period that is  
19 worth examining. We had, of course, a very rapid  
20 expansion and very rapid economic growth rate in  
21 that period, but I think that a careful examination  
22 would indicate that the primary reason for that  
23 rapid growth was the fact that corporations in Canada  
24 because of certain demand expectations decided to  
25 expand, and it was because of this expansion -- a  
26 pretty excessive kind of expansion, as a matter of  
27 fact -- that gave rise to full employment and also  
28 gave rise to very rapid economic growth. I think  
29 in that particular period that this was the primary,  
30 or that this is the primary explanation for the very



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high demand, and without having any particular employment policy you just had a very high rate of employment. In a situation like that what do you think is the relevant weight of union action in getting higher wages for the members as against what the general atmosphere of high demand? What do you think produces it has produced the increase in the level of wages? What proportion of it was due to action by unions and what proportion of it was due just to the economic atmosphere in which people were bargaining and working?

MR. BELL: I think, sir, that one would have to take a given period and examine that period. You referred to the pre-1957 period. Well, I think perhaps the first two years, as a matter of fact, just prior to that, the latter part of 1955 up to approximately the end of 1956 is a period that is worth examining. We had, of course, a very rapid expansion and very rapid economic growth rate in that period, but I think that a careful examination would indicate that the primary reason for that rapid growth was the fact that corporations in Canada because of certain demand expectations decided to expand, and it was because of this expansion -- a pretty excessive kind of expansion, as a matter of fact -- that gave rise to full employment and also gave rise to very rapid economic growth. I think in that particular period that was the primary, or that this is the primary explanation for the very



1 rapid growth rates and high level of employment.

2 COMMISSIONER LEMAN: Well, how would you  
3 analyse the thing after; from 1957 to 1961, say?

4 MR. BELL: From 1957 to 1961, this, of  
5 course, was an entirely -- or, has been an entirely  
6 different kind of situation. Since 1957 there has  
7 been a lack of effective demand in the economy. There  
8 has not been sufficient demand to sustain full  
9 employment or adequate growth rates. As you know,  
10 our economic growth over these last few years has  
11 been among the lowest of the advanced industrial  
12 countries. As a matter of fact, because of this slow-down,  
13 or because of the reduction in aggregate demand, the  
14 Gross National Product, or the per capita Gross  
15 National Product is even less today, or it was less  
16 in 1961 than it was in 1956. There was not any  
17 increase over that period; in other words in output  
18 of goods and services per man, woman and child.  
19 Consequently this period could thus be described as  
20 one of a very considerable deficiency in aggregate  
21 demand.

22 I appreciate, of course, -- I do not want  
23 to over-simplify this because I appreciate that there  
24 are other problems; regional problems which have to  
25 be taken into account. However, at the same time  
26 we have had in this period a very serious over-all  
27 national problem which was not the case in the  
28 preceding years of our post-war period.

29 COMMISSIONER LEMAN: Well, not talking in  
30 terms of what is practical to suggest to any particular





MR. BELL: From 1957 to 1961, this, of course, was an entirely -- or, has been an entirely different kind of situation. Since 1957 there has been a lack of effective demand in the economy. There has not been sufficient demand to sustain full employment or adequate growth rates. As you know, our economic growth over those last few years has been among the lowest of the advanced industrial countries. As a matter of fact, because of this slow-down or because of the reduction in aggregate demand, the Gross National Product, or the per capita Gross National Product is even less today, or is less than in 1961 than it was in 1950. There was not any increase over that period, in other words in output of goods and services per man, woman and child. Consequently this period could thus be described as one of a very considerable deficiency in aggregate demand.

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COMMISSIONER LEMAN: Well, not talking in terms of what is practical to suggest to any particular



1 union that is bargaining at the time, do you think,  
2 however, that any change in economic activity such  
3 as we have seen, and we think now in terms of pre-1957  
4 and post-1957 when there was a real change -- this  
5 seems to have been the pivot year -- there is any  
6 relationship between the rate of wages, or the average  
7 level of wages and the level of employment or un-  
8 employment in the country? Do you think it would be  
9 reasonable to expect that if wages came down some  
10 in such a situation that it could have some effect  
11 on employment?

12 MR. BELL: No, I would answer that very  
13 definitely. I do not think that it would be possible  
14 as a matter of fact to produce evidence to indicate  
15 that a reduction in wages would make any contribution  
16 to employment. On the contrary, I would go so far  
17 as to say that if we had any significant cut in wages  
18 in this country we would simply aggravate our unemployment  
19 problem.

20 I mentioned a moment ago that one of the  
21 reasons for the economic state that we have had over  
22 the past few years has been the deficiency in aggregate  
23 demand. One of the demand forces operative in our  
24 economy, of course, is wages, and if wages are cut  
25 then obviously this reduces, or this would reduce  
26 purchasing power, and a reduction in purchasing  
27 power would, of course, further lower unemployment.

28 Now, I know the arguments that have been  
29 raised on the other side. Those arguments are well  
30 known here, and to put them very briefly, those who



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1 propound these arguments profess to believe that  
2 wages have risen rapidly and have contributed to  
3 competitive difficulties, and that is competitive  
4 difficulties in respect of foreign imports, but I  
5 find that those who make these arguments have yet to  
6 produce any evidence to substantiate them.

7 COMMISSIONER LEMAN: Well, why is it that  
8 in this particular field there should not be, or cannot  
9 be a response; a classical type of response to demand  
10 in terms of wage levels? For instance, what I had in  
11 mind is why does not the inter-play of the sort that one  
12 man earning \$3 an hour would not create as much demand as  
13 two men earning say \$2.50?

14 MR. BELL: You are posing a hypothetical  
15 problem, sir.

16 COMMISSIONER LEMAN: Yes, naturally I am  
17 making it hypothetical. I am trying to illustrate  
18 the type of action I have in mind. Why is it that  
19 there is such rigidity all of a sudden and wages are  
20 not responsive to demand in times of a slackening in  
21 the economy?

22 MR. BELL: I think to some extent that wages  
23 are. This is difficult to quantify, but I think that  
24 to some extent wages are responsive to demand conditions.  
25 As a matter of fact there is evidence that there is  
26 a relationship between the two. However, at the same  
27 time, if you are suggesting that there is not the  
28 same relationship today as existed say several decades  
29 ago, I would admit this and very happily so because  
30 the kind of free inter-play of market forces which

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1 you are suggesting would simply lead to the kind of  
2 instability which we experienced very severely in  
3 years gone by which I personally would not like to  
4 see repeated.

5 COMMISSIONER LEMAN: Well, would you  
6 describe the extent to which you say they are  
7 responsive? How does it work in practice? What is  
8 the response?

9 MR. BELL: What is the response?

10 COMMISSIONER LEMAN: You said that wage  
11 rates are responsive to demands.

12 MR. BELL: I said to a certain extent.

13 COMMISSIONER LEMAN: Yes, that is it, and  
14 I said to what extent.

15 MR. BELL: To a certain extent there is.  
16 There are all kinds of areas where presumably there  
17 is a greater relationship, or more of an inter-play  
18 in market forces in this respect than in other areas.  
19 It is very, very difficult to specify and be precise.

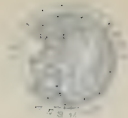
20 COMMISSIONER MACKINTOSH: Is not the  
21 short answer that while instances of wage reductions  
22 are rare, instances of demand for much more moderate in-  
23 creases in periods of slack demand are fairly frequent?

24 MR. BELL: During slack demand periods you  
25 are suggesting that wage rate increases are less?

26 COMMISSIONER MACKINTOSH: Yes.

27 MR. BELL: Yes, that is very definitely  
28 true. As a matter of fact the figures for the last  
29 several years -- the figures I quoted a little while ago  
30 from memory -- bear that out quite clearly.





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29 several years -- the figures I quoted a little while ago

30 from memory -- bear that out quite clearly.



1                   COMMISSIONER LEMAN: Well, now, I think you  
2 told us a little earlier that we were not very well  
3 equipped with figures to measure productivity in the  
4 economy as a whole.

5                   MR. BELL: Quite right.

6                   COMMISSIONER LEMAN: This can be done by  
7 industry quite well, can it not?

8                   MR. BELL: Well, businessmen whom I have  
9 talked with in respect of this subject tell me that  
10 this is an exceedingly difficult thing to do. As  
11 a matter of fact, not very long ago I happened to  
12 sit in on a discussion where representatives of a  
13 particular company were in attendance. They indicated  
14 that measuring productivity in their particular company  
15 was an exceedingly difficult thing to do. This seems  
16 to be a typical reaction. Productivity is not easy  
17 by any means to measure with any kind of accuracy.

18                   I would like to see this, however. We would  
19 like to see our Dominion Bureau of Statistics make  
20 an effort at publishing such data. I think that their  
21 argument is that because of the imprecise data they  
22 have they would not want to release it. However, on  
23 the other hand the Bureau of Labour Statistics in  
24 the United States does make an effort in this direction.

25                   COMMISSIONER LEMAN: This stems from the  
26 difficulty of measuring to what extent better tools  
27 have been supplied to the workers, or why is it so  
28 difficult to measure productivity?

29                   MR. BELL: Well, it depends on the particular  
30 industry. As you know, in the case of some industries



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- 6527 -

1 where you have a product mix it is exceedingly  
2 difficult under these circumstances to measure  
3 productivity. Whereas, in certain other industries,  
4 for example, in mining, the measurement of productivity  
5 would be a much less difficult thing to undertake.  
6 Sometimes, as a matter of fact, it is even difficult  
7 to get common agreement on figures of productivity,  
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1 COMMISSIONER LEMAN: Until everyone is  
2 satisfied that we can get reasonably good figures on  
3 this score, it seems a little hopeless to try to  
4 adopt a wages policy that would be related to this  
5 factor of productivity?

6 MR. BELL: Most precisely, yes. Absolutely.  
7 Even if we were in a position to bargain nationally  
8 or centrally it would be very difficult to formulate --  
9 at least, in my opinion it would be very difficult  
10 to formulate what wage goals should be for a given  
11 period without having accompanying productivity data  
12 that could be relied upon. And as a matter of fact,  
13 productivity data, although certainly significant,  
14 are not the only determinants, or would not be the  
15 only determinants, either, in the matter of formulating  
16 wage policies. There are other determinants as well.

17 COMMISSIONER LEMAN: It would not necessarily  
18 be the only anchor, but it could be one anchor?

19 MR. BELL: That is right.

20 COMMISSIONER MACKINTOSH: I am not sure  
21 that this is entirely relevant, but out of curiosity  
22 I would like to ask a question. We had, some weeks  
23 ago, a Swedish economist, Erik Lundberg, before us.  
24 He told us that in Sweden they followed, with, I  
25 understood, the full support of labour, a policy of  
26 uniform wages across the country, with no concessions  
27 to depressed industries or depressed areas; that the  
28 policy was to force the industries either to achieve  
29 an adequate productivity, or get out; and, with a  
30 measure giving a variety of government assistance, to





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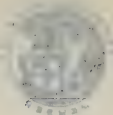
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1 force the population to move if there was no alternative  
2 in the sense of productive employment in the area.

3 I take it this would be looked upon as  
4 pretty strong medicine in this country.

5 MR. MacDONALD: Doctor, your conception is  
6 a little bit different than ours as to what obtains  
7 in Sweden, as a matter of fact. As a matter of fact,  
8 just about a year ago now I went into Sweden for  
9 the specific purpose of studying into that situation,  
10 and that is not my concept of it. More recently  
11 we had, as perhaps you are aware, three distinguished  
12 Swedish gentlemen, the president of the Swedish L.O.,  
13 which is the national labour centre of the manual  
14 workers in Sweden; Mr. Kugelberg, who is the head of  
15 the S.A.F., the Swedish Employers Federation, and  
16 the secretary of the Labour and Social Department,  
17 who would be comparable to our Deputy Minister of  
18 Labour. They visited us here and attended a  
19 tripartite conference between government, labour and  
20 management. It is true that at the national level  
21 in Sweden -- and we very much admire them for their  
22 attainments in this regard -- the two basic parties  
23 get together with the blessing of the third one, the  
24 government, and in the light of the very best data  
25 available which is acceptable to both of them, they  
26 arrive at a conclusion as to what the standard or over-  
27 all increase should be for the subsequent year. Then  
28 that, of course, is translated down to the affiliates  
29 and the component parts of the employers organization  
30 of S.A.F., and it has tremendous moral suasion. But I



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1 do not know of any use of force in the situation.

2 COMMISSIONER MACKINTOSH: Do not misunder-  
3 stand me. I did not mean that the government inter-  
4 vened. My understanding is the same as yours, that  
5 to a surprising and attractive degree they are able  
6 to get a general policy out of the negotiations between  
7 employers.

8 MR. MacDONALD: Exactly.

9 COMMISSIONER MACKINTOSH: But a further  
10 understanding was that out of this group came a fairly  
11 ruthless pressure to raise wages in the depressed  
12 areas, accepting as the bitter alternative that  
13 unemployed should be thrown on the government doorstep,  
14 rather than that they should be nursed along in the  
15 area at what they considered inadequate wages.

16 As I say, this is a little off the track  
17 of our argument, but it interested me as a very bold  
18 policy which I think in this country would probably  
19 require to be even bolder.

20 MR. MacDONALD: We are great admirers of  
21 what is going on in Sweden, and we are paying a great  
22 deal of attention to it at the moment. We are  
23 delighted to find that our interest is now becoming  
24 shared by government and many employers. Actually,  
25 the philosophy, as I understand it, does not quite  
26 parallel your description. There is a process of  
27 rationalization which accompanies the overall collective  
28 bargaining position within what they term the labour  
29 market. But the motivation, as I understand it, is  
30 considerably different.



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the philosophy, as I understand it, does not quite

parallel your description. There is a process of

rationalization which accompanies the overall collective

bargaining position within what they term the labour

market. But the motivation, as I understand it, is

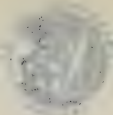


1           As a matter of fact, it is not to throw the  
2 unemployed workers out, when jobs fold up because of  
3 the rationalization process, on the doorstep of  
4 government. Quite the contrary. My understanding  
5 is that under their programme, which is a very precise  
6 and planned programme to eliminate unemployment, the  
7 whole effort is bent in the direction of creating new  
8 forms of productive employment within the economy for  
9 these individuals.

10           I think that it is one of the great beacons  
11 of the western world today, what they are accomplishing  
12 in this connection. I saw at first hand on both my  
13 visits to Sweden what is being done, and I never at  
14 any point detected any force or coercion in the  
15 situation. Quite the opposite. The employers and  
16 the employees organizations, both their organizations,  
17 agree on the elimination in some instances of uneconomic  
18 sections of industry. They do this well in advance  
19 of its closing and follow through very carefully with  
20 their programme of providing employment either within  
21 that locality, if it is possible, and in many instances  
22 they have been successful in creating another industry  
23 where the previous one has been closed, or else  
24 encouraging -- that is quite true: I certainly would  
25 not use the word "force" because there is no force  
26 involved -- encouraging workers to retrain either  
27 for other available employment in the immediate  
28 area or to transfer to available employment in some  
29 other area.

30           The incentives both to industry to locate,





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other area.

The incentive goes to industry to locate,



1 to establish themselves and get themselves operating  
2 on an efficient, economic basis, and for the workers  
3 are marvellous, because it includes their families  
4 and everything else; and the assistance that becomes  
5 available to employers under these circumstances, I  
6 think it is amazing, to say the least.

7 COMMISSIONER MACKINTOSH: I think you  
8 misunderstood me in part, Mr. MacDonald, in repeating  
9 this. I do not know whether I used the word "force"  
10 or not; but in any case, all I meant was a firm  
11 policy. Further, I did not go on and say what the  
12 government did with the co-operation of the unions  
13 and management about the unemployed. I was merely  
14 struck with the idea that they were not afraid to  
15 confront the economy with the prospect of unemploy-  
16 ment in order to achieve a re-arrangement, some re-  
17 orientation of industry.

18 MR. MacDONALD: It would be quite true  
19 to describe it as a very bold and imaginative policy  
20 which is implemented with the co-operation, the  
21 complete co-operation, of all three groups within  
22 the economy.

23 COMMISSIONER MACKINTOSH: Oh, entirely.

24 MR. MacDONALD: Yes.

25 COMMISSIONER LEMAN: Mr. MacDonald, do  
26 you have any figures that would prove whether this  
27 policy has worked, in fact, in terms of the differences  
28 in wage levels in various industries in Sweden,  
29 compared with the variations in Canada between industries?  
30 Is it much more standard or is it much more uniform



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compared with the variations in Canada between industries?





1 in Sweden than it is here?

2 MR. MacDONALD: The wage levels?

3 COMMISSIONER LEMAN: Yes.

4 MR. MacDONALD: Yes, the wage levels are,  
5 I think... There is less differential within the  
6 wage structure than there would be in Canada. That  
7 is my impression. We do have data that could be  
8 available. I do not have it at the moment, obviously,  
9 because I did not foresee the trend of this discussion.  
10 But they do make available a tremendous amount of  
11 information in this connection.

12 COMMISSIONER LEMAN: This greater uniformity  
13 that Mr. Lundberg was explaining to us, as Dr.  
14 Mackintosh pointed out, was the result of a conscious  
15 policy; it was not just happenstance.

16 MR. MacDONALD: No; it is a very careful,  
17 well thought-out, planned policy.

18 THE CHAIRMAN: We will adjourn for a fifteen  
19 minutes break.

20  
21 --- Short recess.

22  
23 THE CHAIRMAN: We will now resume.

24 COMMISSIONER MACKINTOSH: Mr. MacDonald,  
25 your major policy recommendation, I take it, is  
26 what you call somewhere a "massive expansion in the  
27 public sector of the economy". I take it that by  
28 "massive" you mean very great. Is there any other  
29 reason why you used the word? What just is the  
30 connotation of the word "massive"?



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reason why you used the word? What just is the

reason for the word "massive"?



1 MR. BELL: What we have in mind here, sir,  
2 is a very large, very substantial development of those  
3 things which lie in the public sector, and we have  
4 very briefly enumerated in our brief those things,  
5 slum clearance, urban redevelopment, public redevelopment,  
6 ment, conservation of resources, housing, hospitals,  
7 schools, provincial universities, and so forth.

8 This is certainly not, by any means,  
9 an exhaustive list. We have set these out as examples.  
10 All of them are very important examples, but if we  
11 were really presenting a more detailed presentation  
12 we would have many others to include. We believe that  
13 the so-called public sector of our economy has been  
14 very seriously neglected now for many years; that  
15 there is a real deficiency here; and that consequently  
16 by concentrating more in this particular area we  
17 would accomplish two objectives. One objective  
18 would be the supplying of, or the fulfilling of needs  
19 in this area, and secondly, the fulfilling of these  
20 needs would in turn lead to an increase in employment.

21 COMMISSIONER MACKINTOSH: Do you imply  
22 at all that this policy would be cyclical in its  
23 implementation, or is your concern here growth?

24 MR. BELL: Our concern here is more for  
25 achieving full employment and increasing the growth  
26 rate. It is quite true that the question of cyclical  
27 policy does enter into it to a certain extent, but  
28 I should make it very clear that we are not simply  
29 advocating this programme on an ad hoc basis. We  
30 believe that there are real deficiencies here, and





MR. BELL: What we have in mind here, sir, is a very large, very substantial development of those things which lie in the public sector, and we have very briefly enumerated in our brief those things, slum clearance, urban redevelopment, public redevelopment, conservation of resources, housing, hospitals, schools, provincial universities, and so forth. This is certainly not, by any means, an exhaustive list. We have set these out as examples. All of them are very important examples, but if we were really presenting a more detailed presentation we would have many others to include. We believe that the so-called public sector of our economy has been very seriously neglected now for many years; that there is a real deficiency here; and that consequently by concentrating more in this particular area we would accomplish two objectives. One objective would be the supplying of, or the fulfilling of needs in this area, and secondly, the fulfilling of these needs would in turn lead to an increase in employment.

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1 there are going to be deficiencies here for a considerable  
2 period of time to come. Consequently, we believe that  
3 we should allocate more of our resources -- I should  
4 not say "allocate more of our resources". Let me  
5 put it this way: I think that now with the kind  
6 of economic conditions that we have, where we have  
7 considerable unemployment in this country, we can  
8 afford to undertake these projects without reducing  
9 effort in the private sector of the economy.

10 COMMISSIONER MACKINTOSH: We have had  
11 others before us who were inclined to argue that a  
12 greater improvement in aggregate demand could be  
13 achieved by tax reduction, rather than increase in  
14 expenditures. What are your views on that?

15 MR. BELL: Could I just ask, what tax  
16 reductions do they have in mind? Are they con-  
17 cerned with personal income taxes, corporation  
18 taxes?

19 COMMISSIONER MACKINTOSH: Yes, I think  
20 they were pretty catholic in their views of taxes;  
21 personal, corporate commodities.

22 MR. BELL: Could I deal first of all with  
23 the suggestion that has been made by many, that a  
24 reduction in corporate income taxes would lead to  
25 a solution of our economic problems. We do not  
26 believe that this would be the case, for this reason.  
27 There is already very considerable unused industrial  
28 capacity in Canada, and consequently tax concessions --  
29 right across the board, that is, -- would not under  
30 those circumstances likely lead to a capital expansion.



there are going to be difficulties here for a considerable period of time to come. Consequently, we believe that we should allocate more of our resources -- I should not say "allocate more of our resources". Let me put it this way: I think that now with the kind of economic conditions that we have, where we have considerable unemployment in this country, we can afford to undertake these projects without reducing effort in the private sector of the economy.

COMMISSIONER MACKINTOSH: We have had others before us who were inclined to argue that a greater improvement in aggregate demand could be achieved by tax reduction, rather than increase in effort. What do you think?

MR. BELL: Could I just ask, what tax reductions do they have in mind? Are they considering the personal income tax?

COMMISSIONER MACKINTOSH: Yes, I think they were pretty catholic in their views of taxes; personal, corporate, commodities.

MR. BELL: Could I feel free of all with the suggestion that has been made by many, that a reduction in corporate income taxes would lead to a solution of our economic problems. We do not believe that this would be the case. For this reason there is already very considerable unused industrial capacity in Canada, and consequently tax concessions -- right across the board, that is, -- would not under those circumstances likely lead to a capital expansion.





Nethercut & Young

Toronto, Ontario

- 6536 -

1 The reason that capital expansion is not taking  
2 place today -- in other words, the reason that the  
3 level of private capital investment is down by  
4 comparison with its post-war peak, which was  
5 in 1957, is simply because of the lack of effective  
6 demand for our goods.

7 So consequently making tax concessions  
8 to corporations, which this school of thought proposes,  
9 is not going to solve that problem at all. If there  
10 were actually a lack of private capital funds, if  
11 this were the problem, then of course our answer  
12 would be very much different. But there is no lack  
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1 Now, those who argue that tax concessions  
2 are necessary in order to enable Canadian industries  
3 to modernize their equipment, are overlooking in my  
4 view a very important factor, and that is that we  
5 have an excellent system of depreciation allowances  
6 in Canada and these depreciation allowances are available  
7 to the corporations to modernize their equipment if  
8 they deem it necessary to do so, so consequently I  
9 just failed to understand the logic behind the argument  
10 or the school of thought that thinks that a reduction  
11 in corporate tax is all that is required to get our  
12 economy going again.

13 COMMISSIONER MACKINTOSH: We are talking  
14 here in terms of aggregate; some effect would fall  
15 if some corporations and some industries had unfilled  
16 demand and could start the expansion process; it is  
17 not necessary that there be an additional demand over  
18 the total to start the process of expansion?

19 MR. BELL: Some corporations, sir?

20 COMMISSIONER MACKINTOSH: Some corporations,  
21 some industries have need for, presumably, investment  
22 and can expand, but I am not sure you are correct  
23 in saying that capital is readily available. It is  
24 in certain circumstances if we import enough.

25 MR. BELL: The point which I was trying to  
26 make, sir, is that generally speaking our corporations  
27 have sufficient capital funds available to them if  
28 they wish to expand.

29 I would like to just refer again to the  
30 1955 to 1957 period where we had very considerable





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have sufficient capital funds available to them if

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I would like to just refer again to the

1955 to 1957 period where we had very considerable



1 capital expansion and yet the tax "burden" was just  
2 as heavy then as it is now -- possibly slightly  
3 heavier, as a matter of fact -- but this didn't deter  
4 them from expanding. Now, the reason that they expanded  
5 then, of course, was because they had considerable  
6 demand expectations. Unfortunately, these demand  
7 expectations didn't exactly materialize, but at least  
8 they anticipated that there would be effective demand  
9 for an increased output, and therefore they went ahead  
10 and expanded.

11 Now, I think that the same would be true  
12 today if corporations in Canada had demand expectations,  
13 but they don't.

14 COMMISSIONER MACKINTOSH: And as large  
15 profit margins?

16 MR. BELL: Pardon?

17 COMMISSIONER MACKINTOSH: As large demand  
18 expectations as they had in the previous period and  
19 as large profit margins?

20 MR. BELL: The reason their profit  
21 margins are lower now than they have been in previous  
22 years is largely because they are operating at less  
23 than capacity. If they were operating at full capacity  
24 or near full capacity their profit margins would go  
25 up considerably.

26 COMMISSIONER MACKINTOSH: Plus something  
27 like I would think over those years from 1956 about  
28 a 30 per cent wage increase?

29 MR. BELL: I am sorry, I didn't hear you.  
30 Over which period?



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COMMISSIONER MACKINNON: And as large

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MR. BELL: I think so.

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 as large profit margins?

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 years is largely because they are operating at less  
 than capacity. If they were operating at full capacity  
 or near full capacity their profit margins would go  
 up considerably.

COMMISSIONER MACKINNON: I understand.

Like I would think over those years from 1956 about  
 a 30 per cent wage increase?

MR. BELL: I am sorry, I didn't hear you.

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1 COMMISSIONER MACKINTOSH: Over the latter  
2 half of the 1950's, isn't that right?

3 MR. BELL: Over the latter half of the  
4 1950's?

5 COMMISSIONER MACKINTOSH: Yes.

6 MR. BELL: A wage increase of how much?

7 COMMISSIONER MACKINTOSH: Aggregating about  
8 30 per cent?

9 MR. BELL: Just what period, though, 1955  
10 to 1960?

11 COMMISSIONER MACKINTOSH: Yes, or 1961.

12 MR. BELL: I haven't got the figures here,  
13 the aggregate figures, but I doubt very much that it  
14 would be that much over that particular period.

15 COMMISSIONER MACKINTOSH: My recollection  
16 is that it is substantially of that note, and that  
17 profits are about even or down a bit.

18 MR. BELL: Profit margins now?

19 COMMISSIONER MACKINTOSH: Yes.

20 MR. BELL: Well, profit margins are lower  
21 now, quite true, than they have been in previous  
22 years, but then again I think this is almost solely  
23 because industry in so many cases is operating at  
24 much less than capacity. Certainly I think this is  
25 the primary reason for this somewhat reduced profit  
26 margin.

27 COMMISSIONER MACKINTOSH: What about personal  
28 income taxes?

29 MR. BELL: As far as personal income taxes  
30 are concerned, there may be a very good reason for



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income taxes?

MR. BELL: As far as personal income taxes

are concerned, there may be a very good reason for



1 reducing them to a certain extent, particularly in  
2 the lower income classes, because such reductions  
3 would lead to an increase in purchasing power.

4 I think, as a matter of fact, that this  
5 might be a very feasible approach to take, but at  
6 the same time I think that something more is needed  
7 than that alone, and that something more in our view  
8 is an expansion and a very considerable expansion in  
9 the public sector of our economy.

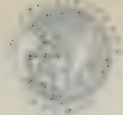
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11 approach and please do not misunderstand us; we are  
12 not saying for one moment that this is the sole  
13 solution to our problems; far from it. At the same  
14 time, we believe that it should be given very  
15 considerable emphasis because it is in this area of  
16 our economy where there is such a great demand for  
17 goods and services, public demand for goods and  
18 services, and in fulfilling this demand we could  
19 achieve a lot in the way of reducing unemployment.  
20 And, of course, as the economists point out, expansion  
21 in this particular area would also have a very important  
22 multiplier effect on the private sector as well, so  
23 that the net effect would be a very considerable  
24 increase in the total aggregate demand in our economy.

25 COMMISSIONER MACKINTOSH: Of course, you  
26 have undermined my question to some extent by mentioning  
27 the universities in this list, and having declared  
28 my interest in the matter ---

29 MR. MacDONALD: We were aware of this!

30 COMMISSIONER MACKINTOSH: I would suspect





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solution to our problems far from it. At the same time, we believe that it should be given very considerable emphasis because it is in this area of

our economy where there is such a great demand for goods and services, public demand for goods and services, and in fulfilling this demand we could achieve a lot in the way of reducing unemployment.

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COMMISSIONER MACKINTOSH: I would respect

1 the Minister of Finance -- whom I have not consulted --  
2 would say, "This is an attractive thing but I have  
3 already acquired, created or inherited a very  
4 substantial deficit on my budget, which it might be  
5 argued comes in part from the adoption of policies  
6 of increased social welfare payments, which are  
7 comparatively rigid, and related to population to a  
8 considerable extent and therefore create -- along  
9 with other items -- create deficits when revenues  
10 should falter or fall."

11 Does this represent any change? I mean,  
12 does the recommendation you are making represent any  
13 change in the point of view of the Congress as between  
14 welfare payments and what you might call social capital  
15 expenditures, anything other than a difference between  
16 the two periods?

17 MR. BELL: I am not sure that I understand  
18 the change in our policy with respect to a different ---

19 COMMISSIONER MACKINTOSH: I am assuming  
20 that you thought increased old age pensions -- this  
21 sort of thing -- a good thing. Now, I think the Minister  
22 of Finance would say, "If I didn't already have this  
23 deficit which comes from these comparatively rigid  
24 or population related expenditures, I would like to  
25 go into these social capital expenditures, they  
26 attract me."

27 Are these the alternatives, or is your  
28 contention that you can go along and have them both?

29 MR. BELL: Our contention would be that we  
30 can go along and have them both and for this reason --



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contention that you can go along and have them both?

MR. BELL: Our contention would be that we

can go along and have them both and for this reason --





1     which I think is a very sound economic reason -- that  
2     as long as we have considerable unused capacity in our  
3     economy, industrial capacity and resources, and a  
4     considerable number of unemployed, that a planned  
5     deficit budget to finance this so-called expansion  
6     of the public sector would have -- well, it would  
7     have this very beneficial effect, but apart altogether  
8     from actually accomplishing these particular projects,  
9     it would have the effect of raising the national  
10    income and, as a matter of fact the result of raising  
11    the national income would, of course, result in  
12    increased tax revenues to the government and out of  
13    the increased tax revenues the government would be  
14    able to pay off or liquidate the interest payments  
15    and principal involved in financing these projects.

16           In other words, by adopting this particular  
17    approach we would over a period of a relatively few  
18    short years raise very considerably the national  
19    income and, of course, once full employment had been  
20    attained, then obviously deficit financing or a  
21    deficit budget would have to be replaced by a balanced  
22    budget in order to avert inflationary pressures, but  
23    until full employment has been attained or as long  
24    as there are unused resources, both human and physical,  
25    then increasing deficit financing for the purpose of  
26    doing these things would certainly not be inflationary.

27           So consequently we can afford to do these  
28    things now because of our unused resources, and at  
29    the same time we can retain our social welfare programmes  
30    or even improve upon them, as a matter of fact.

which I think is a very sound approach, as long as we have considerable unused capacity in our economy, industrial capacity and resources, and a considerable number of unemployed, that a planned deficit budget to finance this so-called expansion of the public sector would have -- well, it would have this very beneficial effect, but apart altogether from actually accomplishing these particular projects, it would have the effect of raising the national income and, as a matter of fact, the result of raising the national income would, of course, result in increased tax revenues to the government and out of the increased tax revenues the government would be able to pay off or liquidate the interest payments and principal involved in financing these projects. In other words, by adopting this particular approach we would over a period of a relatively few short years raise very considerably the national income and, of course, once full employment had been attained, then obviously deficit financing or a deficit budget would have to be replaced by a balanced budget in order to avoid inflationary pressures, but until full employment has been attained or as long as there are unused resources, both human and physical, then increasing deficit financing for the purpose of doing these things would certainly not be inflationary. So consequently we can afford to do these things now because of our unused resources, and at the same time we can retain our social welfare programs.



1                   COMMISSIONER MACKINTOSH: I don't want  
2 to explore it in detail, but the specific objects  
3 which you have mentioned would require very  
4 extensive and specific agreements among the national  
5 government, the provinces and the municipalities, since  
6 different governments are responsible for different  
7 expenditures, and your recommendation I think goes  
8 in the direction of almost a complete consolidation  
9 of national governmental expenditure in the sense  
10 of including all three levels of government, in which  
11 those responsible for government in the past have found  
12 very real difficulties.

13                   MR. BELL: Some of these things, of  
14 course, might come under the sole jurisdiction of the  
15 Federal Government but it is quite true, as you say,  
16 that many of them would involve appropriate arrangements  
17 among the three levels of government.

18                   COMMISSIONER MACKINTOSH: In other  
19 words, it couldn't be massive unless it is?

20                   MR. BELL: Yes. You mentioned the  
21 municipalities and I would like to mention -- and  
22 you are probably aware of this -- that the Federation  
23 of Mayors and Municipalities have rather frequently  
24 in their submissions to the Federal Government pointed  
25 out and documented the great needs that exist at  
26 the municipal level in Canada and many of the things  
27 we are proposing, as a matter of fact, would have  
28 their endorsement.

29                   COMMISSIONER MACKINTOSH: Of course,  
30 they are not alone and that practice is still before us;





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they are not alone and that therefore is still before us;



1 they pointed out the great urgent needs of their  
2 particular group.

3 MR. BELL: If I might just make this comment; many  
4 have said -- including the highest official levels --  
5 that these things are desirable but they usually raise  
6 the question, "How does one go about financing them?"  
7 There is nothing particularly unconventional in the  
8 method of financing that we are suggesting, and just  
9 to repeat again -- because I think it is exceedingly  
10 important that we make this point clear -- that there  
11 is no reason why the Federal Government cannot use  
12 a planned budget deficit for the purpose of financing  
13 these things given the kind of economic conditions  
14 that we have now.

15 Now, of course, we wouldn't advocate this  
16 method of financing if we had full employment. If  
17 these particular objectives were considered to be  
18 socially desirable, given a period of full employment,  
19 then obviously you would have to resort to taxation  
20 because otherwise you would be creating a demand in  
21 the economy that couldn't be met because all of your  
22 resources were fully employed, but in Canada today  
23 this is far from being the case. Therefore we feel  
24 that it is economically feasible to advocate deficit  
25 financing, and a considerable amount of deficit  
26 financing, for the purpose of financing these things.

27 I am sorry for talking too long, but I  
28 would just like to revert to the point that you made  
29 or the point that you raised a little while ago,  
30 and that is with regard to the kind of deficits that



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MR. BELL: If I might just make this comment, may

have said -- I think I have said that --

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I am sorry for talking too long, but I

would just like to revert to the point that you made

or the point that you raised a little while ago,

and that is with regard to the kind of deficits that





1 Canada has been incurring in recent years.

2 Now, to a large extent these deficits --  
3 and, as a matter of fact, I think you more or less  
4 explained or certainly implied this -- that these  
5 deficits were to a large extent really more involuntary  
6 than voluntary; involuntary in the sense that the  
7 Minister of Finance just did not anticipate revenues  
8 falling off. He found that his revenues fell off too  
9 much to meet his expenditures.

10 COMMISSIONER MACKINTOSH: To some degree  
11 they are automatic, but I cannot assume that the  
12 automatic feature of them was not foreseen and planned,  
13 but I don't know. They are in the system, if you want  
14 to put it that they, but whether they are deliberately  
15 in the system or by inadvertence is not for me to  
16 judge.

17 MR. BELL: The contrast between what has  
18 actually happened and what we propose is that we would  
19 aim for a certain level of growth, whatever level of  
20 growth is necessary to provide and sustain full  
21 employment.

22 Now, some have suggested an average annual  
23 5 per cent growth in Canada would be necessary to provide  
24 full employment. I doubt that anybody knows just  
25 exactly what percentage growth rate is required at  
26 the present time, but whatever that is or whatever  
27 it is assumed to be, we would work or we would want  
28 the government to work towards achieving that growth  
29 rate and thus provide or bring about the conditions  
30 necessary to provide full employment.



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the Government to work towards achieving that growth

rate and thus provide or bring about the conditions

necessary to provide full employment.



1                   COMMISSIONER MACKINTOSH: I think 5 per cent  
2 was a bit ambitious. However, that is a matter of  
3 judgment.

4                   COMMISSIONER GIBSON: I should like to ask  
5 a few questions about your section on exchange rate  
6 policy. You say in fact that you prefer a free  
7 type of exchange rate because it allows for adjustment  
8 of balance of payments to the needs of the domestic  
9 policy. I understand the theory that says this  
10 should be so, but it does not seem to have worked  
11 that way recently. Have you any explanation of why  
12 our exchange rate, when we had a free one, stayed  
13 so high and so obviously out of line with our domestic  
14 economic interests? This has been true for  
15 several years.

16                  MR. BELL: Yes, I agree that when we had  
17 a fixed exchange rate our dollar was over-valued.

18                  COMMISSIONER GIBSON: No, this was when we  
19 had the free exchange.

20                  MR. BELL: When we had the free exchange rate?

21                  COMMISSIONER GIBSON: Yes.

22                  MR. BELL: It was over-valued, taking into  
23 account the considerable imbalance in our current  
24 transactions ---

25                  COMMISSIONER GIBSON: And taking into  
26 account our domestic interests and use of our resources,  
27 and so on.

28                  MR. BELL: Precisely. The government  
29 apparently recognized this, but our view is that the  
30 government adopted the wrong approach or measures to





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was a bit ambitious. However, that is a matter of judgment.

COMMISSIONER GIBSON: I should like to ask

the questions about your action on exchange rate

policy. You say in fact that you prefer a free

type of exchange rate because it allows for adjustment

of balance of payments to the needs of the domestic

policy. I understand the theory that says this

should be so, but it does not seem to have worked

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MR. BELL: Yes, I agree that when we had

a fixed exchange rate our dollar was over valued.

COMMISSIONER GIBSON: No, this was when we

had the free exchange.

MR. BELL: When we had the free exchange rate?

COMMISSIONER GIBSON: Yes.

MR. BELL: It was over-valued, taking into

account the considerable imbalance in our current

transactions --

COMMISSIONER GIBSON: And taking into

account our domestic interests and use of our resources

and so on

separately recognized that our view is that the government adopted the wrong approach or measures to



1 bring about a devaluation of our dollar when it was  
2 at a premium over the American dollar. We believe  
3 that if the government had adopted what we considered  
4 appropriate policies for dealing with our unemployment  
5 situation and our low economic growth rates at that  
6 time, instead of forcing the devaluation of the dollar  
7 as it did, these appropriate measures which would  
8 have brought lower interest rates in Canada and thus  
9 reduced the interest rate differential between this  
10 country and the United States, that the borrowings  
11 that were taking place by our municipalities and  
12 provincial governments, and so on, in the American  
13 money market, would have been considerably reduced.

14 As a matter of fact, this would have  
15 reduced their incentive to borrow in the New York  
16 money market. Consequently, this would have relieved  
17 pressure on our Canadian dollar and our dollar would  
18 have been devalued in a gradual and orderly way  
19 without the artificial intervention that took place  
20 as the result of government action at that time.  
21 Consequently, I do not think we would have had a  
22 premium on our dollar at all if these steps had been  
23 taken, but it was apparent that the government decided  
24 that all that was really required was to bring about  
25 the reduction in the value of the dollar; it did not  
26 favour the expansionary policies that would have  
27 automatically brought this about. Consequently it  
28 had to step in, or thought it had to step in and,  
29 what I call, artificially devalue the dollar. I think  
30 this is where we got ourselves into a real dilemma,



this is where we got ourselves into a real dilemma, what I call, artificially leveling the dollar. I think had we stepped in, or thought it had to step in and, automatically brought this about. Consequently it favours the expansionary policies that would have the reduction in the value of the dollar; it did not that all that was really required was to bring about taken, but it was apparent that the government decided premium on our dollar at all if these steps had been. Consequently, I do not think we would have had a as the result of government action at that time, without the artificial intervention that took place have been devalued in a gradual and orderly way pressure on our Canadian dollar and our dollar would money market. Consequently, this would have helped reduced their incentive to borrow in the New York As a matter of fact, this would have money market, would have been considerably reduced, provincial governments, and so on, in the American that were taking place by our municipalities and country and the United States, near the borrowing reduced the interest rate differential between this have brought lower interest rates in Canada and thus as it did, these appropriate measures which would time, instead of forcing the devaluation of the dollar situation and our low economic growth rates at that appropriate policies for dealing with our unemployment that if the government had adopted what we considered as a realistic view of the situation, we believe





1 a dilemma which to a certain extent we are still in.

2 COMMISSIONER GIBSON: The government was  
3 running a pretty substantial deficit during most of  
4 this period when we had a significant amount of  
5 unemployment and felt our dollar was over-valued.  
6 I should like to ask you: do you really think that  
7 is the whole story? How about the problem of the  
8 foreigners' attitude towards this country and their  
9 continued desire to put money in and buy things  
10 here despite the fact we have this big balance of  
11 payments deficit? In other words, we have to take into  
12 account our very close proximity to the United States  
13 and the tremendous movements of money into Canada which  
14 had occurred. Do you not think this complicates the  
15 problem?

16 MR. BELL: It is a very complicated problem.

17 COMMISSIONER GIBSON: Complicating so far  
18 as explaining this phenomenon?

19 MR. BELL: I am not quite sure that I  
20 follow you.

21 COMMISSIONER GIBSON: You gave a pretty  
22 straight forward and simple -- I mean simple in a  
23 polite sense -- explanation of why you thought we  
24 had too high an exchange rate. I am suggesting to  
25 you that it is a good deal more complicated than that.

26 MR. BELL: The point, if I may reiterate this,  
27 is that I think the reason we had an over-valued dollar --  
28 an over-valued dollar that certainly was not in our  
29 interests -- was that we were importing certain capital  
30 that was not necessary to be imported, and that capital



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13 running a pretty substantial deficit during most of

14 this period when we had a significant amount of

15 unemployment and left our dollar was over-valued.

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17 is the whole story? How about the problem of the

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26 MR. BELLE: It is a very complicated problem.

27 COMMISSIONER GILSON: Complicated as far

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32 straight forward and simple -- I mean simple in a

33 polite sense -- explanation of why you thought we

34 had too high an exchange rate. I am suggesting to

35 you that it is a good deal more complicated than that.

36 MR. BELLE: The point, in I may rephrase this,

37 is that I think the reason we had an over-valued dollar

38

39

40 was the necessity to be imported, and that capital



1 was coming in through the borrowings taking place  
2 by our provincial and municipal governments and, to  
3 a certain extent, by certain corporations. They  
4 borrowed from the American money market because of  
5 lower interest rates there, and it was to their  
6 advantage to do so, but our position is that if the  
7 government at that time had been pursuing expansionary  
8 policies for the purpose of solving the unemployment  
9 problem, it would not have had to intervene in the  
10 foreign exchange rate markets as it did. If our  
11 interest rates had been reduced as the result of  
12 expansionary policies, as a result of expansion of  
13 money supply which needed to be expanded, for example,  
14 at that time, then I think there would not have been  
15 any inducement on the part of our people to have gone  
16 down to the United States money markets.

17 COMMISSIONER GIBSON: I can see this in  
18 terms of borrowing in New York but I am not at all  
19 sure I can see this in terms of the kind of deliberate  
20 capital inflow that was coming from the United States  
21 to buy existing assets, and this is something which  
22 was quite important during this period as well. The  
23 motivation there does not seem to be just an interest  
24 rate matter.

25 MR. BELL: The interest rate factor is very  
26 important in so far as public bodies are concerned.

27 COMMISSIONER GIBSON: That is true.

28 MR. BELL: I would say it is exceedingly  
29 important, and it seems to me that at that time it  
30 was these borrowings that were just sufficient to bring





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COMMISSIONER GREGORY: I can see this in  
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important in so far as public bodies are concerned.  
COMMISSIONER GREGORY: That is true.  
MR. FRILL: I would say it is extremely  
important, and it seems to me that at that time it



1 that extra pressure to bear on the Canadian dollar  
2 to maintain it at a premium.

3 COMMISSIONER MACKINTOSH: May I interject  
4 at this point, Mr. Gibson? I avoided this question  
5 of the discipline of foreign markets in my discussion  
6 with you, Mr. Bell, but I should like to interject  
7 that, without discussing the total validity of your  
8 proposition, it would be much more attractive to a  
9 Minister of Finance if he could start it at a time  
10 when his budget was balanced and when the rate of  
11 exchange was still at a premium. Now, he has been  
12 visited with, or has created, a very substantial  
13 deficit and his rate of exchange is already at a  
14 substantial discount, and the practical difficulties  
15 of going on from there are very substantial; at least  
16 I am sure they would appear so to a Minister of  
17 Finance.

18 COMMISSIONER GIBSON: Well, carrying on in  
19 the same area, having fixed an appropriate rate of  
20 exchange with the International Monetary Fund, which  
21 presumably fits our national interests, our domestic  
22 economic interests, reasonably well, do you believe  
23 it is in our interest to change that policy now, or  
24 are you simply saying as a long-range policy you  
25 prefer a flexible or free rate of exchange?

26 MR. BELL: As we have indicated, or tried  
27 to indicate in our submission, what we are afraid  
28 of with a fixed rate of exchange is that it will tie  
29 our hands when it comes to employing what we consider  
30 appropriate internal domestic policies to expanding



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COMMISSIONER MACKINNON: May I interject

with you, Mr. Bell, but I should like to interject  
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to indicate in our submission, what we are afraid

of with a fixed rate of exchange is that it will tie

our hands when it comes to employing what we consider

appropriate internal domestic policies to expanding





1 economic growth.

2 COMMISSIONER GIBSON: With a 92½ dollar  
3 do you not think there should be a floor? Our rate does  
4 give us a fair amount of latitude.

5 MR. BELL: I could counter by asking you  
6 just where our dollar would be if we had a floating  
7 exchange rate?

8 COMMISSIONER GIBSON: I do not know.

9 MR. BELL: Nobody else does either. But I  
10 think it would be a pretty fair assumption that our  
11 dollar would not be too far off where it is now if  
12 we had a floating exchange rate. Certainly it would  
13 probably be around 90 cents anyway. So, I do not think  
14 there would be any real difference as far as the  
15 actual extent of the devaluation was concerned, whether  
16 we had a floating or a fixed exchange rate, but if I  
17 could come back to the real reason why we are concerned  
18 about a fixed exchange rate, it is that government  
19 fiscal policies may very well have to be tailored  
20 to supporting that fixed exchange rate, and at the  
21 same time those particular policies may be running  
22 contrary to our internal interests such as full  
23 employment and suitable economic growth rates.

24 COMMISSIONER GIBSON: Do you not think the  
25 sort of rate we have does give us a reasonable degree  
26 of latitude? Surely there is some level at which  
27 we should want to support the exchange rate. You  
28 said you were interested in reasonably stable prices.

29 MR. BELL: We had floating exchange rates  
30 between the year October, 1950, when we went off the



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MR. BELM: I could answer by asking you  
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COMMISSIONER GILSON: I do not know.

MR. BELM: Nobody else does either. But I

think it would be a pretty fair assumption that our

dollar would not be too far off where it is now if

we had a floating exchange rate. Certainly it would

probably be around 50 cents anyway. So, I do not think

there would be any real difference so far as the

actual extent of the devaluation was concerned, whether

we had a floating or a fixed exchange rate, but if I

could come back to the real reason why we are concerned

about a fixed exchange rate, it is that government

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COMMISSIONER GILSON: Do you not think the

sort of rate we have does give us a reasonable degree

of latitude? Surely above its some level at which

we should want to support the exchange rate. You

said you were interested in reasonably stable prices.

MR. BELM: We had floating exchange rates

between the year October, 1930, when we went off the



1 fixed exchange rate, up until about the end of 1960  
2 when the Minister of Finance began to tinker with  
3 the exchange rate. I think that a floating exchange  
4 rate served this country's economic interests quite  
5 well.

6 COMMISSIONER GIBSON: Do you not think the  
7 exchange rate was a little high, say, in 1958 on in  
8 terms of our economic interests? We had unemployed  
9 resources in that period and our imports were pretty  
10 high and our exports were not high enough.

11 MR. BELL: Yes, I certainly agree with that,  
12 but then, as I pointed out before, I think that if  
13 certain internal policies had been pursued in this  
14 country at that time we would not have had a premium  
15 on our dollar, even with a floating exchange rate.

16 COMMISSIONER GIBSON: In other words, you  
17 have a very strong preference for a free rate, but  
18 would you agree that in certain circumstances it is  
19 desirable to support the rate in the national interests?

20 MR. BELL: If you have a floating exchange  
21 rate you do not support it, do you?

22 COMMISSIONER GIBSON: The point I am getting  
23 at is that if you had a nice, even movement as you did  
24 from 1950 to 1960, the idea of supporting it does not  
25 really come up. The only idea that really came up  
26 in that period was it was too high towards the end  
27 of the period. But suppose you changed the rate under  
28 pressure, would you not agree there are times this  
29 would involve implications in terms of price increases,  
30 to a degree that is more than sensible in





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exchange rate was a little high, say, in 1985 or in

terms of our economic interests? We had unemployed

resources in that period and our imports were pretty

high and our exports were not high enough.

MR. BRINK: Now, I certainly agree with that,

but that, as I pointed out before, I think that if

certain interest payments had been entered in this

country at that time we would not have had a premium

on our dollar, even with a floating exchange rate.

COMMISSIONER BRINK: In other words, you

have a very strong preference for a free rate, but

would you agree that in certain circumstances it is

desirable to support the rate in the national interest?

MR. BRINK: If you have a floating exchange

rate you do not support it, do you?

COMMISSIONER BRINK: The point I am getting

at is that if you had a fixed, even movement as you did

from 1975 to 1980, the idea of supporting it does not

really come up. The only idea that really came up

in that period was it was too high, towards the end

of the period. But suppose you changed the rate under

pressure, would you not agree there are times this

would involve implications in terms of price increases,

is a degree that is more than sensible in



1 the interests of the country?

2 MR. BELL: I would suggest that the exchange  
3 funded account would be sufficient to modify any  
4 fluctuations that would arise if we were on a floating  
5 exchange rate basis. However, if there was considerable  
6 pressure on the dollar it might be necessary, as a  
7 matter of fact, for the government to step in and  
8 give support to the dollar if the dollar began to  
9 fall. But I just do not envisage that taking place.  
10 I do not think, as a matter of fact, there would be  
11 very much difference now from what we experienced in  
12 the 1950's with regard to maintaining a fairly even  
13 gear as far as our exchange rate is concerned, if this  
14 trend of events had not been set off by the government  
15 towards the end of 1960.

16 COMMISSIONER GIBSON: Yes, but whatever  
17 you may think of the events that have occurred, we  
18 are where we are right now and one has to have a  
19 view about this situation.

20 MR. BELL: I appreciate that.

21 COMMISSIONER GIBSON: I will suggest to  
22 you that we reached a position where it became  
23 desirable to define our exchange rate at some level,  
24 and that this is why we have a fixed rate.

25 MR. BELL: As we suggested in our submission,  
26 it might not be possible to revert to a floating  
27 exchange rate, certainly at the present time or perhaps  
28 for some time to come, but in thinking of alternatives  
29 it seems to us that we cannot go back to a floating  
30 exchange rate then we should try to secure approval

MR. BRILL: I would suggest that the exchange

traded account would be sufficient to modify any  
fluctuations that would arise if we were on a floating

pressure on the dollar it might be necessary, as a  
matter of fact, for the government to step in and  
give support to the dollar if the dollar began to

fall. But I just do not envisage that taking place.  
I do not think, as a matter of fact, there would be  
very much difference now from what we experienced in

the 1950's with regard to maintaining a fairly even  
gear as far as our exchange rate is concerned. If this  
trend of events had not been set off by the government  
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1 from the International Monetary Fund to have a  
2 bit wider latitude for our exchange rate.

3 At the present time, as you are well aware,  
4 the International Monetary Fund requires us to maintain  
5 our fixed exchange rate within a very narrow latitude,  
6 one percentage point on either side. In our view  
7 this is too small a margin, given the kind of pretty  
8 unique economic circumstances with which we are faced  
9 in Canada.

10 COMMISSIONER GIBSON: I would not disagree  
11 with your view. It sounds very sensible. But why do  
12 you think in putting up this point of view, which  
13 obviously has appeal from the Canadian outlook, that  
14 the Fund would be particularly interested in considering  
15 it? I mean, this would necessitate the United States  
16 and leading nations of Western Europe going along with  
17 this idea, and some of them, the European countries,  
18 have been through rather great exchange rate difficulties  
19 and they had to put up with the rules and regulations  
20 of the Fund. Do you think they would be willing to  
21 change this to suit us or to suit other countries  
22 which might be in a similar position?

23 MR. BELL: Of course, I am not in a position  
24 to know just what kind of a response we would get from  
25 the International Monetary Fund, but they certainly  
26 made a major concession to us in September, 1950,  
27 when we had particular circumstances there which  
28 they believed warranted making certain accommodations  
29 with us, and it seems to me that our official represent-  
30 atives should be making a pretty strong representation



THE INTERNATIONAL MONETARY FUND

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Nethercut & Young

Toronto, Ontario

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2 of difficulties that we are now encountering, and  
3 persuade them that the kind of pretty rigidly fixed  
4 exchange rate we have just does not harmonize with  
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1                   COMMISSIONER GIBSON: I was just wondering  
2 if you had any view on our chances of doing this.

3                   COMMISSIONER MACKINTOSH: May I interject  
4 there, perhaps on the other side of this amicable  
5 discussion. Without committing myself to an overall  
6 view, nevertheless I think there is a case for saying  
7 that the floating exchange rate in 1955-56 or there-  
8 abouts was a period of great capital imports and  
9 accommodated itself to what we now look upon as over-  
10 investment, over-borrowing from an external source  
11 and gave no signal at all that anything was wrong,  
12 whereas a fixed exchange rate would have given some  
13 kind of signal and pointed the finger at the economic  
14 circumstances which were later to cause us very  
15 considerable difficulty.

16                   I just interject that so that the floating  
17 exchange rate will not have quite the halo on it that  
18 you have been giving it.

19                   COMMISSIONER LEMAN: Mr. Gibson, may I  
20 also interject something here?

21                   COMMISSIONER GIBSON: Yes.

22                   COMMISSIONER LEMAN: I am a little surprised  
23 by Mr. Bell's confidence that it is a reasonable  
24 assumption that the Canadian dollar would be at  
25 about 90 cents U.S. now if it was left free. Suppose,  
26 for the sake of discussion, we go along with you on  
27 that and say that right now it would be about 90 to  
28 92 cents if it was free. Where would it go, if the  
29 kind of deficit and expansionary policies you suggest  
30 we should adopt, were adopted? What would it do to



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1 the dollar?

2 MR. BELL: You are apprehensive that the  
3 dollar might fall below 90 cents if the kind of  
4 domestic expansionary policies which we are pressing  
5 for are implemented; is that right?

6 COMMISSIONER LEMAN: I am asking you, what  
7 do you think it would tend to put the dollar at?  
8 If you admit that right now it would be at 90 cents  
9 without this expansionary policy, what would happen  
10 to it with the expansionary policy?

11 MR. BELL: With a floating exchange rate?

12 COMMISSIONER LEMAN: Yes.

13 MR. BELL: With a floating exchange rate  
14 I do not know that there would actually be much change,  
15 because if there were certain tendencies or pressures,  
16 downward pressures, on our dollar, with the floating  
17 exchange rate you would have a self-corrective  
18 mechanism. For example, if the government were to  
19 pursue the kind of expansionary policies that we are  
20 interested in, there might of course be a tendency  
21 for imports to rise, because usually whenever you  
22 get an expanding economy in Canada there is this  
23 tendency for imports to increase. It is for this  
24 reason, or this is one of the reasons why we are  
25 interested in having a floating exchange rate; it is  
26 to correct that kind of situation, because with a  
27 floating exchange rate, if there was a tendency for  
28 imports to rise, then the effect on our dollar would  
29 eventually bring about a correction for a better  
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1 balance between our imports and our exports.

2 But with a fixed exchange rate, I find it  
3 very difficult to conceive of a fixed exchange rate  
4 helping a situation like this. If you have an  
5 expansion of your economy which leads to a rise in  
6 imports, there is no change in your external rate;  
7 consequently you have not got your exchange rate  
8 acting as a deterrent to excessive imports. With  
9 a floating exchange rate, I think it does serve as  
10 a deterrent to excessive imports.

11 COMMISSIONER GIBSON: As Dr. Mackintosh  
12 says, with a fixed rate you do get a real signal.  
13 Your reserves start to go down if your balance of  
14 payments is turning more against you. This tells  
15 you that you have a problem that you need to do some-  
16 thing about. In this context I would like to ask  
17 you this question. Supposing Canada does not find it  
18 practical to go back to a free rate and does not  
19 succeed in getting wider latitude from the I.M.F.  
20 Would you feel that your plans for domestic expansion  
21 would have to be altered to some degree to fit that  
22 change? You said this is what you would like, but  
23 supposing you do not get it? Would you feel that  
24 your suggestions for public works, tax reductions,  
25 and so on, would have to be tailored to some extent?

26 MR. BELL: It sounds repetitious and  
27 it probably is repetitious of what I have said;  
28 but I am apprehensive that a fixed exchange rate will --  
29 I do not know just to what extent, of course -- put  
30 certain restraints on domestic policies.





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REMARKS BY MR. YOUNG

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1 COMMISSIONER GIBSON: It does put limits  
2 on them. Whether they are restraints, or not,  
3 depends on the circumstances.

4 MR. BELL: Yes. This, incidentally, is  
5 the reason why we are so hep, I suppose, on the  
6 floating exchange rate, because with a floating  
7 exchange rate you do not have these restraints.  
8 For example, with a floating exchange rate our  
9 government would not now be aiming for a balanced  
10 budget. Given the kind of circumstances we now have,  
11 aiming for a balanced budget is the most unrealistic  
12 approach possible.

13 COMMISSIONER GIBSON: I think the minister  
14 suggested the other day that the deficit was going  
15 to be \$570 million. That is not quite balanced.

16 MR. BELL: No. It is quite true that  
17 there is a difference between having a balanced  
18 budget and aiming for one; but the fact that they  
19 are supposedly aiming for a balanced budget indicates  
20 to me that certain restraints -- well, undoubtedly  
21 certain restraints have been imposed upon them.  
22 The mere fact that they have borrowed from the Inter-  
23 national Monetary Fund and the Import-Export Bank,  
24 the Bank of England, and so forth, undoubtedly must  
25 have involved certain obligations.

26 I do not need to tell you, sir, that when  
27 one goes to a bank and borrows money there are  
28 certain conditions laid upon the borrower. Undoubtedly  
29 the same thing takes place with regard to transactions  
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1 between our government and these foreign banks.

2 COMMISSIONER GIBSON: But do not we  
3 ultimately have to accept a certain amount of external  
4 discipline if (1) we want to obtain resources from  
5 abroad on a reasonable basis and (2), and this is  
6 much more important, if we want to have reasonable  
7 stability and confidence in our own currency at home?

8 Is there not a certain discipline attached to this?

9 Is it not one of the facts of life that we have to  
10 accept? Whether we have a floating rate or a fixed  
11 rate, this still applies, does it not?

12 MR. BELL: It is a discipline, though,  
13 that carries with it a very high price, as far as  
14 employment is concerned. I think you will agree  
15 with this.

16 COMMISSIONER GIBSON: You have to weigh  
17 one against the other, in the circumstances. It  
18 seems to me that it is absolutely vital to have  
19 confidence in your own currency. I would say this  
20 was one of the things you must have; you must have  
21 confidence in your money.

22 MR. BELL: But I am suggesting that if  
23 we had been on a floating exchange rate today, if  
24 what has happened had not happened, we would not  
25 have the exchange rate difficulties that we have  
26 at the present time.

27 COMMISSIONER GIBSON: We are looking at a  
28 situation, and there is the situation.

29 MR. BELL: Yes, but we do not know yet,  
30 as a matter of fact, whether we are out of this exchange



COMMISSIONER GIBSON: But do not we

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MR. BELL: Yes, but we do not know yet, as a matter of fact, whether we are out of this exchange



1 rate difficulty or not. As a matter of fact, we  
2 could easily get into another situation in the relatively  
3 near future where pressure was brought to bear against  
4 our dollar, even though it is now at a fixed exchange  
5 rate.

6 COMMISSIONER MACKINTOSH: May I interject  
7 here? I think, with some over-simplification, your  
8 argument adds up to this, that in undertaking this  
9 programme of expansion, this massive investment,  
10 unless the exchange rate goes down the spill-over  
11 of imports will seriously reduce your multiplier effect?

12 MR. BELL: Unless the exchange rate  
13 goes down?

14 COMMISSIONER MACKINTOSH: Yes.

15 MR. BELL: With a floating exchange rate,  
16 of course, it would go down, in the circumstances.

17 COMMISSIONER MACKINTOSH: And this would  
18 preserve more of your multiplier effect?

19 MR. BELL: That is right; this would act  
20 as a deterrent effect against imports and you would  
21 have more of a multiplier effect against a balanced  
22 economy.

23 COMMISSIONER LEMAN: What do you think  
24 the International Monetary Fund authorities want?  
25 Do you think they have these rules because they  
26 want Canada to wallow in a very tough, unacceptable  
27 level of economy activity, or is it just because they  
28 feel there are certain, appropriate ways of trying  
29 to improve your economy, and certain less appropriate  
30 ones?





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1 MR. BELL: Let me make very clear, first  
2 of all, that I am not prejudiced against the International  
3 Monetary Fund. It serves a very useful purpose.  
4 But at the same time, I do not think that uniform  
5 rules can be -- in all areas, that is -- laid down  
6 by the International Monetary Fund, because of the  
7 very wide economic disparities between countries.

8 I think one of the chief functions of  
9 the International Monetary Fund is to see that countries  
10 do not get involved in competitive exchange depreciation.  
11 This is something I would be very, very much opposed  
12 to, because we experienced this years ago and all of  
13 us suffered very adverse consequences from that  
14 kind of thing. But at the same time, I think there  
15 are other areas where a certain degree of flexibility  
16 has got to be permitted. That is why I think Canada  
17 should at least try to secure some concession from  
18 the International Monetary Fund. It may not be feasible  
19 to revert to a floating exchange rate, from their  
20 point of view; but at the same time, I think they  
21 have got to give us some more flexibility with respect  
22 to our exchange rate.

23 COMMISSIONER LEMAN: It is one per cent  
24 up and down now. How much per cent up and down would  
25 really help you much?

26 MR. BELL: No, I am not concerned with  
27 the extent of devaluation at this point, because with  
28 a floating exchange rate I do not think there would  
29 be very much difference between what the rate is now  
30 and what it would be.

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1                   COMMISSIONER GIBSON: But what margin do you  
2 think the fund ought to give us? I think that is  
3 what Mr. Leman was asking.

4                   MR. BELL: The margin either side?

5                   COMMISSIONER GIBSON: Yes.

6                   MR. BELL: This is purely arbitrary, but  
7 we have thought in terms of five points on either side,  
8 which would provide a greater degree of flexibility  
9 than the one point on either side now provides for  
10 us.

11                   I would like to make just one additional  
12 comment here, because we have pointed this out in  
13 our submission. A country like Canada -- and others  
14 too, as a matter of fact -- would be able to function  
15 with a fixed exchange rate if there was not this  
16 problem of international liquidity. If this problem  
17 could be solved, then it would be much easier for  
18 us to operate on a fixed exchange rate. As a matter  
19 of fact, under those circumstances, a fixed exchange  
20 rate might be quite feasible.

21                   COMMISSIONER GIBSON: This just gives you  
22 more time to make the necessary adjustments; it  
23 does not alter the fact that you have to adjust  
24 yourselves to the conditions of the outside world.  
25 Having a big reserve means that you get more room  
26 to move around in, but you still have to make your  
27 adjustments which your balance of payments position  
28 forces on you; isn't that correct?

29                   MR. BELL: Yes, but in my view a floating  
30 exchange rate would permit us to make better adjustments



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1 than with a fixed exchange rate.

2 COMMISSIONER GIBSON: The difference,  
3 though, in a floating exchange rate and more liquidity  
4 is that a floating exchange rate can, in theory, make  
5 any adjustment required; but perhaps it would result  
6 in a greater depreciation in currency; whereas the  
7 greater liquidity gives you time to make the necessary  
8 adjustment. I think that is the essential difference.

9 MR. BELL: Supposing, sir, that a floating  
10 exchange rate resulted in a greater depreciation of  
11 our currency. What damaging effect do you foresee  
12 from that condition?

13 COMMISSIONER GIBSON: I was asking you  
14 that question because --

15 MR. BELL: I do not see any particular  
16 thing to worry about.

17 COMMISSIONER GIBSON: You are not concerned  
18 about the rise in price level that would result from  
19 that? Over a period of time our price level would  
20 adjust itself to the exchange rate. It does not  
21 do this rapidly, but it does do it.

22 MR. BELL: I do not follow this. I do  
23 not see that it would have any contributing effect  
24 to price increases.

25 COMMISSIONER GIBSON: It did after the  
26 war, for example. Our price level adjusted itself  
27 to the American price level and the American exchange.  
28 If our rate goes down to a lower rate, in terms of  
29 the American dollar, we are going to have higher  
30 prices than the Americans, more or less related to





with a fixed exchange rate

COMMISSIONER GIBSON: I am not sure

in a floating exchange rate and more liquidity  
is that a floating exchange rate can, in theory, make  
any adjustment required; but perhaps it would result  
in a greater depreciation in currency; whereas the  
greater liquidity gives you time to make the necessary  
adjustment. I think that is the essential difference.  
MR. HELL: Supposing, sir, that a floating

exchange rate resulted in a greater depreciation of  
our currency. What damaging effect do you foresee

COMMISSIONER GIBSON: I was asking you

that question because --

MR. HELL: I do not see any particular

thing to worry about.

COMMISSIONER GIBSON: You are not concerned

about the rise in price level that would result from

that? Over a period of time our price level would

adjust itself to the exchange rate. It does not

do this rapidly, but it does do it.

MR. HELL: I do not follow that. I do

not see that it would have any countervailing effect

to price increases.

COMMISSIONER GIBSON: It did after the

war, for example. Our price level adjusted itself

to the American price level and the American exchange

rate went down to a lower rate, in terms of

the American dollar, we are going to have higher

prices than in the United States, more or less related to



1 the difference in the rates. It takes quite a while.

2 You know this.

3 MR. BELL: But, again, our primary concern  
4 here is that with a fixed exchange rate our government may  
5 be hampered or handicapped in pursuing the policies  
6 that are required to bring about full employment or  
7 to substantially reduce the amount of unemployment  
8 that we have in this country. So consequently, if  
9 this reasoning is valid, we could not possibly accept  
10 a fixed exchange rate, precisely for that reason.

11 COMMISSIONER GIBSON: Why could you not  
12 accept a 92½ cents dollar? Surely that gives a  
13 reasonable margin?

14 MR. BELL: I am sorry, sir.

15 COMMISSIONER GIBSON: Why could you not  
16 accept a 92½ cents dollar? This gives us quite a  
17 margin; it is a reduction of 12 points from the previous  
18 level.

19 MR. BELL: Yes, but this is not my concern  
20 at all. I can accept a 92½ cents dollar, but it is  
21 the fact that the fixed 92½ cents dollar prevents us  
22 from having the necessary internal flexibility.

23 COMMISSIONER GIBSON: When you say "prevents  
24 us", you are sort of suggesting that it ought to be  
25 even more?

26 MR. BELL: No; it is the fact that it is  
27 a fixed rate, not the fact that it is at 92½ cents  
28 or 90 cents.

29 COMMISSIONER MACKINTOSH: What you mean is  
30 that in the future it may have this preventive effect?



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25 even more?

26 MR. BELL: No; it is the fact that it is

27 a fixed rate which prevents us from having

28 or 90 cents.

29 COMMISSIONER MARKINGHAM: What you mean is

30 that in the future it may have this preventive effect?





1 You do not feel it is inhibiting now, but some time  
2 in the future it may?

3 MR. BELL: Yes. I am sure I do not  
4 have to explain this to Mr. Gibson. With the kind  
5 of economy that we have, with the kind of open  
6 economy that we have, a floating exchange rate, it  
7 seems to me, is much better in adapting our internal  
8 needs and requirements to our balance of payments.  
9 This is what bothers me: If we had a more closed  
10 economy, such as the United States has, which is  
11 not nearly as dependent on trade as we are -- after  
12 all, we are proportionately much more highly dependent  
13 upon trade than the United States --

14 COMMISSIONER GIBSON: Even the Americans  
15 are being subjected to a certain amount of international  
16 economic discipline now.

17 MR. BELL: Yes, but their circumstances  
18 are quite different from ours.

19 COMMISSIONER GIBSON: Oh, yes.

20 MR. BELL: If it was not for these  
21 particular circumstances, which you well know are  
22 the American commitments abroad, which are the cause  
23 of their imbalance on current account transactions,  
24 then they would have no particular problem. But that  
25 is something else again.



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1 MR. BELL: With the kind of open economy  
2 we have had, or comparatively, it seems to me that  
3 a fixed interest rate is not going to work very well  
4 unless, of course, we are willing to accept a com-  
5 paratively high level of unemployment. This is  
6 something, of course, which we certainly cannot  
7 under any circumstances accept.

8 COMMISSIONER GIBSON: I have a couple of  
9 more questions in this area, namely, as to the use  
10 of foreign capital to balance our current account  
11 deficit. Do you have any particular views about  
12 the scale of the capital inflow that is occurring  
13 to balance our accounts, and which is still occurring  
14 and has been over the last five or six years?

15 MR. BELL: I think we would have to answer  
16 that in this way. First of all imported capital is  
17 necessary to promote economic expansion, and quite  
18 apart altogether from the balance of payments problem  
19 import capital is essential. If the government were  
20 to adopt measures to drastically reduce imported  
21 capital then I think the dire result would be a very  
22 safe aggravation of the whole problem, so we have  
23 a natural tendency to place pretty great emphasis  
24 on the contribution that the capital makes toward  
25 expanding jobs.

26 Now, at the same time we are, of course,  
27 concerned about foreign capital. We have some concern  
28 about foreign capital taking over Canadian concerns,  
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1 foreign capital is resulting in direct interference  
2 with the Canadian economy, and if that is true, of  
3 course, then it certainly is a valid objection. We  
4 are just concerned that any measures that would reduce  
5 the import of foreign capital to the extent that  
6 those measures would contribute to unemployment  
7 would certainly not be looked upon very happily.

8 COMMISSIONER GIBSON: If the deficit were  
9 reduced by importing less or exporting more, or both,  
10 this would presumably provide more jobs in Canada?

11 MR. BELL: Yes, if this could be done  
12 we could reduce our current account deficit through  
13 increasing our exports.

14 COMMISSIONER GIBSON: Or reducing our  
15 imports?

16 MR. BELL: Or reducing our imports. Then,  
17 of course, this would be a very happy solution, but  
18 as long as we cannot do it this way we are going to  
19 be dependent to a considerable extent on foreign  
20 capital, perhaps unfortunately, but nevertheless to  
21 look at it from a purely realistic view I am afraid  
22 this may well continue to be the case.

23 COMMISSIONER GIBSON: You are not concerned  
24 about the theory that says it is the import of foreign  
25 capital that has tended to create a big import deficit.

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28 MR. BELL: Yes, I have heard this theory  
29 expressed many times. This may to a certain extent  
30 be true, but I have yet to see as a matter of fact --



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1 it may be true but on the other hand I have not seen  
2 any substantial documentation.

3 COMMISSIONER GIBSON: Thank you, that is  
4 all.

5 COMMISSIONER BROWN: I would just like to  
6 ask one question in respect of this matter of import of  
7 capital before going on to something else. If this  
8 country did go into a sort of deficit financing as  
9 you suggest, what effect do you think this would have  
10 on the people who are putting the capital into the  
11 country at the moment? Do you think it would change  
12 their attitude at all?

13 MR. BELL: You are suggesting that foreign  
14 investors might lose confidence in us if we continue  
15 to have a budget deficit?

16 COMMISSIONER BROWN: I am not suggesting  
17 anything, I am asking you for your opinion. What  
18 would you think their reaction would be, or do you  
19 think there would be any reaction?

20 MR. BELL: I do not know that there would  
21 be. I know it is frequently suggested that one of  
22 the reasons why foreigners have lost confidence in  
23 our dollar is because of the kind of budget deficit  
24 we have experienced over the past few years. I would  
25 like to offer a few comments on that because I think  
26 this has been greatly exaggerated.

27 I think that one of the main reasons why  
28 there has been a lack of confidence in the past few  
29 years -- there are a number of reasons, of course,  
30 but one is that there simply are not the investment



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but one is that there simply are not the investments



1 opportunities in Canada that there were before. Our  
2 economy has slowed down. It is not as attractive a  
3 place for investors as it was in the earlier years.  
4 I think this is certainly an important explanation  
5 for whatever loss of confidence investors have now  
6 in the Canadian dollar.

7               Now, those who repeatedly focus all the  
8 blame on budget deficits here are obviously over-  
9 looking the fact that European governments are  
10 accustomed to having budget deficits. As a matter of  
11 fact, we have documented that in our brief. Countries  
12 like France, Germany and Sweden -- all the rapid growth  
13 countries -- as a matter of fact frequently have  
14 deficits. Some of them have had budget deficits  
15 stretching consecutively over a decade. There is  
16 no great apprehension on the part of businessmen over  
17 there, they take it for granted. Businessmen, govern-  
18 ments, professional economists view budget deficits  
19 as a matter of fact as being necessary to sustain  
20 this kind of economic growth. I appreciate the fact  
21 that there are other reasons for the rapid economic  
22 growth that has taken place in European countries, and  
23 I am not trying to say that budget deficit is the  
24 only factor, and far from it, but at the same time  
25 budget deficit has played a significant role in these  
26 countries as pointed out by these people themselves.  
27 In North America I think we have a totally unrealistic  
28 fear of deficit financing, or using our budget in the  
29 way that it is customarily used in these countries.  
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1                   COMMISSIONER LEMAN: May I ask something  
2 here? You do make a reference to this fear of deficits  
3 particularly in paragraph 58 of your brief. I am a  
4 little puzzled by the analysis of the comparison  
5 between public debt and personal debt. You say that  
6 one of the reasons why there is this fear is that  
7 people think of public debt in the same sense as they  
8 think of personal debt, and then you say that public  
9 debt, because of its self-liquidating nature should  
10 not be looked upon in the same light as personal debt.

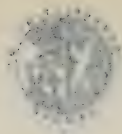
11                   MR. BELL: Yes.

12                   COMMISSIONER LEMAN: Well, now, don't you  
13 think that intelligent personal debt is also of a  
14 self-liquidating nature?

15                   MR. BELL: It depends on the personal debt.  
16 I can think of a lot of personal debts that are not  
17 intelligent.

18                   COMMISSIONER LEMAN: But when it is done  
19 for productive purposes presumably it is self liquidating  
20 in the same sense that national debt is, is it not?

21                   MR. BELL: Well, sir, the only point that  
22 we are trying to make here is that there is a distinction,  
23 or that there is some distinction between the kind  
24 of debt contracted by governments or by corporations  
25 for the purposes of expanding; well, in the case of  
26 governments for the purpose of expanding or bringing  
27 about full employment and expanding economic growth  
28 and the national economy, and in the case of corporations  
29 obviously for the purpose of expanding profits. That is  
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COMMISSIONER LEMAN: May I ask something

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1 why we point out that debt financing or deficit financing  
2 used this way is not only self-liquidating but very  
3 profitable in terms of expanding income, whereas a  
4 lot of individuals have the tendency to think, and  
5 quite rightly so, as a matter of fact, that when they  
6 go into debt, the debt that they contract is really  
7 not contributing to their income at all. An individual  
8 family that goes into debt to buy a television set,  
9 obviously that debt is not contributing to income.  
10 On the contrary, as a matter of fact, it is cutting  
11 down future income.

12 So there is a tendency on the part of  
13 many individuals to equate this kind of personal  
14 debt with government debt so we often find it necessary  
15 to try and draw a distinction between the two.

16 COMMISSIONER LEMAN: Well, did you know  
17 that we have been told in this Commission not very  
18 long ago by people who were sitting right where you  
19 are sitting now that a television set is for a  
20 productive purpose? I just wanted to see exactly  
21 what you meant by this. Would you regard external  
22 debt the same as personal debt in that sense? Would  
23 you distinguish it from national debt that is strictly  
24 inside?

25 MR. BELL: Well, of course, there is a  
26 very clear distinction between national or internal  
27 debt and external, but external debt itself can, of  
28 course, play a part; it can be very productive in  
29 the sense that it leads to an expansion of one's  
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1 debt that this country has contracted over the decades  
2 has been very productive.

3 COMMISSIONER MACKINTOSH: One could add,  
4 Mr. Bell, that the more open and less closed an  
5 economy the more public debt assumes the characteristics  
6 of personal debt? If your economy is closed there  
7 is a much clearer distinction?

8 MR. BELL: Well, to the extent that your  
9 national debt -- or, to the extent that your internal  
10 spending is going outside of the country, I suppose  
11 is what you have in mind. As a matter of fact, it  
12 is much easier to do a lot of things with a more closed  
13 economy than with an open economy. There is no question  
14 about that. We are always faced in Canada with  
15 the problems with a more closed economy, such as  
16 the United States is not faced with, and this has  
17 to be taken into account in all of our calculations.  
18 There is no doubt about that.

19 COMMISSIONER MACKINTOSH: Yes. Economists  
20 have invented all sorts of policies for a closed  
21 policy but they have not been able to invent a closed  
22 economy.

23 COMMISSIONER BROWN: I would like to get  
24 clear one point, and that is, you apparently consider  
25 that a fixed exchange rate inhibits us from carrying  
26 out these policies, and the corollary of this is that  
27 these policies affect the fixed exchange rate problem,  
28 and you said this will effect capital movements in an  
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unsatisfactory manner. Can you just give us your



1 picture of where you think these pressures are going  
2 to come?

3 MR. BELL: Well, I would just like to  
4 amend your statement a little bit. I am not suggesting  
5 that it is impossible to carry out expansionary policies  
6 that we have advocated with a fixed exchange rate.  
7 What I am suggesting is that it is more difficult  
8 to do so; how much more difficult it is very difficult  
9 to conceive, but it is obviously going to be more  
10 difficult to carry out these policies with a fixed  
11 exchange rate. This is the reason, as a matter of  
12 fact, why we have taken such a fairly strong stand  
13 on this question of our foreign exchange rate. We  
14 do not want our foreign exchange rate to determine  
15 our internal or domestic policies. Some economists  
16 have put it, that in the situation we have now it  
17 is sort of the tail wagging the body of the dog.  
18 We are very much afraid, as a matter of fact, that we  
19 are going to stay in this sort of reverse position,  
20 and this is the whole nub of our problem.

21 COMMISSIONER BROWN: What I am trying to  
22 get at is, in which direction do you think the tail  
23 is going to wag the dog? In other words, where is  
24 the pressure coming?

25 MR. BELL: Where will the pressure come?  
26 I am afraid the pressure will come on our government  
27 to adopt more restrictive fiscal and monetary policies.  
28 As a matter of fact, this is what has already occurred  
29 as a result of that fixing of the exchange rate. I  
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1 but as a result, if I may be so blunt as to say, the  
2 government got itself into this exchange rate  
3 dilemma, because I am afraid that, again to be very  
4 blunt about it, I hold the government responsible  
5 for getting us into this position. I think this is  
6 really a self-engineered crisis, not something that  
7 came about naturally.

8 COMMISSIONER BROWN: Well, perhaps we can  
9 go on to some discussion in respect of monetary policy.  
10 You made quite a bit of the discriminatory effects of  
11 monetary policy.

12 MR. BELL: Yes.

13 COMMISSIONER BROWN: You mention three so  
14 affected, namely, public bodies, small businesses  
15 and prospective home builders. Perhaps you could  
16 tell us just how you think these are affected and  
17 to what extent.

18 MR. BELL: Yes. Whenever the Bank of Canada  
19 deems it necessary to pursue restrictive policies  
20 the elements in our society that suffer the most  
21 are the ones we have indicated here; the small business  
22 men is, as you know, to a very large extent dependent  
23 upon bank credits for his financing purposes, and  
24 the higher interest rates that result from a tighter  
25 monetary policy affect him, the municipalities and  
26 provincial governments. The smallest rise in interest  
27 rates results in a very considerable increase in the  
28 cost of borrowing for these particular agencies.  
29 Also, even a small rise in interest rates has very  
30 considerable effect on home owners, or prospective home



...the ...  
...  
...dilemma, because I am afraid that again to be very  
...about it, I hold the government responsible  
for getting us into this position. I think this is  
really a self-engineered crisis, not something that

COMMISSIONER BROWN: Well, perhaps we can  
go on to some discussion in respect of monetary policy.  
You made quite a bit of the discriminatory effects of  
monetary policy.

MR. BELL: Yes.

COMMISSIONER BROWN: You mention things as  
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tell us just how you think these are affected and  
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MR. BELL: Yes. Whenever the Bank of Canada  
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1 owners and home builders who contract mortgage payments  
2 over a long period of years. Now, this is not so  
3 with respect to private corporations because, in  
4 the first place, private corporations are to a very  
5 large extent now capable of financing their needs  
6 through their internally generated funds; through  
7 depreciation allowances and undistributed profits,  
8 so the tight money policy has not nearly the same  
9 effect upon them.

10 Now, we have in mind here the period of  
11 1955 to 1957 again when the Bank of Canada stepped  
12 in and attempted to bring about a restraint on  
13 inflationary pressures. The effect of that policy  
14 was not particularly significant as far as the private  
15 corporations were concerned, yet they were the ones  
16 that were largely responsible for generating these  
17 inflationary pressures. So the effect of the  
18 policy, and it was a very adverse effect, was felt  
19 by provincial governments, municipalities, small  
20 businesses and prospective home builders and so on.

21 COMMISSIONER BROWN: Well --

22 MR. BELL: Excuse me one second, sir.  
23 Consequently we felt that what is needed, and this  
24 may be very difficult, is that we should be inquiring  
25 into the use of a more selective kind of credit  
26 restraint or control. In other words, we felt that  
27 in dealing with a more specific kind of inflationary  
28 pressure the use of the central bank is a bit too  
29 blunt an instrument because it effects sectors of  
30 the economy that are not at all responsible for generating





owners and home builders who have been building houses over a long period of years. Now, this is not so with respect to private corporations because, in the first place, private corporations are to a very large extent now capable of financing their needs through their internally generated funds; through depreciation allowances and undistributed profits, so the tight money policy has not nearly the same effect upon them.

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1 the inflationary pressures, and possible sectors that  
2 need to expand, as a matter of fact, without getting  
3 at this particular sector that is responsible for  
4 the inflationary pressures.

5 COMMISSIONER BROWN: Well, you have repeated  
6 the same general statements that are in your brief.  
7 What I was hoping for was something more specific.  
8 For instance, what evidence have you that small  
9 business was affected in a deleterious manner?  
10 Have you evidence of small businesses that had their  
11 lines of credit reduced and were not able to do the  
12 things that they wanted to do?

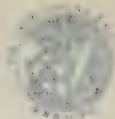
13 MR. BELL: This is quite evident. As a  
14 matter of fact, Mr. Gibson would be able to supply  
15 you with quite a lot of evidence of this.

16 COMMISSIONER GIBSON: I do not agree with  
17 you on that.

18 COMMISSIONER BROWN: All the evidence  
19 we have heard is to the opposite, or is not in line  
20 with your argument. I am asking you if you have any  
21 argument that supports this general statement? On  
22 the face of it it sounds like the logical sequence,  
23 but have you concrete evidence of the extent to which  
24 small businesses have been effected?

25 MR. BELL: Well, as a matter of fact, the  
26 size of bank loans which are published in the Bank  
27 of Canada summary of statistics would bear this out,  
28 I am pretty sure.

29 COMMISSIONER BROWN: Well, let's look  
30 at public bodies. We discussed this with public bodies



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COMMISSIONER BROWN: Well, let's look





1 all across Canada.

2 MR. BELL: Here, of course, it is a  
3 different situation from small business. I am suggesting  
4 in the case of small businesses, because of their  
5 very heavy dependence on bank credit that a squeeze  
6 on the lending capacity of chartered banks affects  
7 them in so far as making available supplies are  
8 concerned, whereas as far as public bodies, provincial  
9 governments and municipalities are concerned, it is  
10 a different matter. Here it is a matter of interest  
11 rates going up and involves a considerable increase  
12 in their borrowing costs.

13 COMMISSIONER BROWN: This is the only effect  
14 in respect of them?

15 MR. BELL: This is the primary effect in  
16 respect of them. This is the primary effect as  
17 far as municipalities and provincial governments are  
18 concerned going into the capital market.

19 COMMISSIONER BROWN: They still make the  
20 same decisions, and that is what I want to make clear.  
21 I want to know what your information is.

22 MR. BELL: Yes.

23 COMMISSIONER BROWN: When you comment in  
24 respect of home builders are you concerned with the  
25 demand factor or the availability factor?

26 MR. BELL: It is a combination of the two  
27 of them as far as prospective home builders are  
28 concerned. They are certainly most definitely affected  
29 by any rise in interest rates. This is very, very  
30 obvious. If you have even an increase of one-half of



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serious. If you have even an increase of one-half of



1 one per cent, it is going to add up to a considerable  
2 sum over a long period of time. Also, the prospective  
3 home builders to the extent that they are dependent  
4 upon securing their loans from the chartered banks  
5 for home building purposes are affected by a reduction  
6 in funds available as well as by an increase in  
7 interest costs.

8 COMMISSIONER BROWN: Now, perhaps you  
9 would care to comment on the use of residential  
10 construction as a counter-cyclical element in the  
11 economy? You mentioned before that in the period  
12 you are talking about, 1955 to 1957, there was a  
13 period of full employment. Therefore perhaps it  
14 was a good thing that some of these other things  
15 were held down, otherwise we would have been in real  
16 trouble.

17 MR. BELL: Excuse me one second. When  
18 we discussed the period 1955 to 1957 and talked about  
19 full employment, of course, during part of 1955 we  
20 were still recovering from the recession that had  
21 started in the latter part of 1953, and there was  
22 still considerable unemployment, but certainly by  
23 the time we got into 1956 our unemployment rate had  
24 come down quite considerably.

25 COMMISSIONER BROWN: Well, you used the  
26 phrase "full employment" with reference to that period.

27 MR. BELL: Yes.

28 COMMISSIONER BROWN: About fifteen minutes  
29 ago and that is where I took it from.

30 MR. BELL: I just wanted to qualify that to





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period of full employment. Therefore perhaps it  
was a good thing that some of these other things  
were held down, otherwise we would have been in real  
trouble.

MR. BELL: Because we are now. When  
we discussed the period 1925 to 1929 and talked about  
full employment, of course, during part of 1925 we  
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started in the latter part of 1923, and there was  
still considerable unemployment, but certainly by  
the time we got into 1928 our unemployment rate had  
come down quite considerably.

COMMISSIONER BROWN: Well, you used the  
phrase "full employment" with reference to that period.

MR. BELL: Yes.

MR. BELL: I just wanted to qualify that to  
say and that is where I took it from.



1 make my statement a bit more accurate.

2 COMMISSIONER BROWN: How about this question  
3 of residential construction as a counter-cyclical  
4 weapon?

5 MR. BELL: It has been used, as a matter  
6 of fact, over the years. It has been used to a  
7 certain extent as a counter-cyclical weapon. However,  
8 I am more concerned with developing housing and urban  
9 development, renewal and so on, along with the other  
10 projects that we have enumerated. We are more  
11 concerned with undertaking these on a larger  
12 scale for the purposes of bringing about full employment  
13 on a steady and regular basis. I do not think we  
14 should depend on residential construction -- housing  
15 construction -- and let it go, for example, until  
16 we get into a period of recession and then start  
17 building houses in order to get us out of that recession.  
18 We are concerned with social needs here and we do  
19 not believe that those social needs are simply to  
20 be put on the shelf and something done about them when  
21 the economy gets into a recession.

22 COMMISSIONER BROWN: Now, some of your  
23 recommendations with respect to direct controls were  
24 fiscal controls?

25 MR. BELL: That is right.

26 COMMISSIONER BROWN: Rather than monetary  
27 controls.

28 MR. BELL: That is right.

29 COMMISSIONER BROWN: You suggested the  
30 variable depreciation rule and, in effect, of course,



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1 this only amounts to the interest cost on the depreciation  
2 flow. How effective do you think this would be on  
3 corporation decisions?

4 MR. BELL: Well, this incidentally is not  
5 suggested here as the ultimate solution by any stretch  
6 of the imagination. What we are interested in doing  
7 is exploring ways and means, whether the variable  
8 depreciation rate be the best, or whether there be  
9 others for the purpose of regulating capital invest-  
10 ment. In other words, so as to avert the kind of  
11 situation we got ourselves into from 1955 to 1957  
12 where we did have over-expansion. Whether the  
13 variable depreciation rate is the best, or whether  
14 there are others that are better, we are not concerned  
15 with that, but what we are concerned with is that  
16 these areas be carefully looked into to find out what  
17 are the best or most feasible means of bringing about  
18 and regulating the flow of capital investments.

19 COMMISSIONER BROWN: The same reasoning  
20 applies to your suggestion in respect of the Capital  
21 Issues Committee.

22 MR. BELL: Precisely.

23 COMMISSIONER BROWN: Yes?

24 MR. BELL: It has worked, as a matter  
25 of fact, in a number of countries and it is in effect  
26 in a number of countries not only with respect to  
27 stock but also with respect to bank loans.

28 COMMISSIONER BROWN: I think I should say  
29 that we have heard that it is not working, so I am  
30 not sure there is not a certain amount of theory around



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1 this.

2 MR. BELL: I know there is a conflict of  
3 opinion about this so far as it applies to an area  
4 like the United Kingdom.

5 COMMISSIONER BROWN: Instead of applying  
6 some of these specific controls how about the reverse?  
7 How about looking at it from the opposite end and  
8 removing some of the present controls? For example  
9 in house building, you mentioned the role of the banks  
10 as suppliers of N.H.A. funds when interest rates  
11 went up. What would your attitude be to the suggestion  
12 that the 6 per cent ceiling on bank charges might be  
13 removed?

14 MR. BELL: No, I personally cannot accept  
15 that because I believe, as we have pointed out here,  
16 that if anything, there needs to be a lowering of  
17 interest rates, not just to meet a particular situation,  
18 because I belong to that school of thought that thinks  
19 that the more and more our gross national product is  
20 devoted to developing things in the public sector ,  
21 there should be lower interest rates. In other words,  
22 so that municipalities, provincial governments and  
23 the federal government as well can undertake to finance  
24 these things at a lower rate.

25 I think, as a matter of fact, with a lower  
26 rate of interest across the board, the present ceiling  
27 of 6 per cent on the banks would be perfectly valid.  
28 It would be more of a margin, as a matter of fact,  
29 between the present 6 per cent and the average interest  
30





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of 6 per cent on the banks would be perfectly valid.

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between the present 6 per cent and the average interest



1 rates now.

2 COMMISSIONER MACKINTOSH: Do you know of  
3 any other measure of adequacy in the economy that  
4 was established in 1933 or about then that still holds?

5 MR. BELL: Yes, the price of gold. Oh,  
6 it was established in 1935.

7 COMMISSIONER MACKINTOSH: You are a couple  
8 of years out.

9 MR. BELL: Yes, two years later.

10 COMMISSIONER MACKINTOSH: We have had  
11 representations that it is not adequate.

12 COMMISSIONER BROWN: Further on you suggest  
13 that the main element in a monetary policy is the cost  
14 of money. Now, what do you think the relative  
15 importance is between cost and availability?

16 MR. BELL: Excuse me. Where do we suggest  
17 that the main element is the cost of money?

18 COMMISSIONER BROWN: Well, let me see;  
19 perhaps my notes are wrong. I read it into  
20 your paragraph 82.

21 MR. BELL: No, here we are concerned with  
22 the issue of whether the central bank should play  
23 an active or passive role in the matter of influencing  
24 interest rates. We are taking objection really to  
25 the position taken by the former Governor of the  
26 Bank of Canada whom I believe appeared before you  
27 yesterday, when he indicated pretty clearly, as  
28 quoted in here, as believing that the Bank of Canada  
29 should take a passive role, and that the Bank of  
30 Canada should not deliberately influence the movement



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1 of interest rates. It seems to me this is quite  
2 a strange theory to advance, because if the central  
3 bank cannot, or if the central bank does not assume  
4 the role of influencing interest rates then this  
5 denies to it one of the very important functions that  
6 a central bank should have in the national economy.

7 COMMISSIONER BROWN: Well, let us put it  
8 this way. Which do you think is the more important  
9 factor in the central banks operations in the monetary  
10 field, the availability of funds or the influencing  
11 of interest rates?

12 MR. BELL: Well, the two are inter-  
13 related, aren't they?

14 COMMISSIONER LEMAN: What is the interest  
15 rate at which public debt becomes non-self-liquidating?

16 MR. BELL: Becomes non-self-liquidating?

17 COMMISSIONER LEMAN: Yes.

18 MR. BELL: I must confess I have never  
19 heard it put this way before.

20 COMMISSIONER BROWN: Well, European countries  
21 have been expanding very much. They have done it in  
22 a period of very high interest rates. This has not  
23 inhibited their expansion.

24 MR. BELL: Yes. Of course, the reason  
25 that their interest rates are higher than ours is,  
26 I think, largely because of a more scarce source of  
27 capital available to them than is the case in North  
28 America. As a matter of fact, I am sure this is  
29 the reason.



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the role of influencing interest rates then this denies to it one of the very important functions that a central bank should have in the national economy. COMMISSIONER BROWN: Well, let us put it this way. Which do you think is the more important factor in the central bank's operations in the monetary field, the availability of funds or the influencing of interest rates?

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COMMISSIONER LAMM: What is the interest rate at which public debt becomes non-self-liquidating? MR. BELM: Becomes non-self-liquidating?

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MR. BELM: Yes. Of course, the reason that their interest rates are higher than ours is, I think, largely because of a more scarce source of capital available to them than is the case in North America. As a matter of fact, I am sure this is the reason.



1 COMMISSIONER LEMAN: Or is it perhaps because  
2 they are higher profit economies?

3 MR. BELL: Well, you have to specify which  
4 economies they are, because some of them may very well  
5 be and others certainly not.

6 COMMISSIONER BROWN: Perhaps we should ask  
7 you for a definition of what you consider to be a high  
8 profit economy?

9 MR. BELL: As a matter of fact, I would  
10 like to direct that question here.

11 COMMISSIONER BROWN: In paragraph 87 you  
12 refer to near banks?

13 MR. BELL: Yes.

14 COMMISSIONER BROWN: And I couldn't  
15 help but note one omission in your list, and I wondered  
16 why it was omitted?

17 MR. BELL: I assume that you are referring  
18 to credit unions?

19 COMMISSIONER BROWN: That is right.

20 MR. BELL: As a matter of fact, we didn't  
21 mean to enumerate all of the so-called near banks  
22 or financial intermediaries.

23 COMMISSIONER BROWN: At the moment they are  
24 a large element, larger than some of those which  
25 you mentioned and I wondered why they were omitted?

26 MR. BELL: We simply listed a few examples  
27 here. As far as the credit unions are concerned,  
28 you probably have already had representations made  
29 to you ---

30 COMMISSIONER BROWN: A great number.





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here. As far as the credit unions are concerned,

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COMMISSIONER BROWN: A great number.



1                   MR. BELL: ... by them. My understanding  
2 of the position that has been taken by some of them --  
3 and this is indirect, I haven't heard the exact  
4 testimony that they offered to you -- but that is  
5 that if it is found that credit unions do have a  
6 considerable effect on monetary policy, then perhaps  
7 some ways and means might have to be devised to bring them  
8 under some regulation, but I think the point that they  
9 would make is that the kind of regulation or the kind  
10 of regulatory power imposed on credit unions might be  
11 very considerably different from other financial  
12 institutions because of the basic difference in their  
13 nature.

14                   COMMISSIONER BROWN: I think you define  
15 their operations quite succinctly in paragraph 88;  
16 it seems to fit into your definition of the other near  
17 banks, but do I gather that you are not omitting them  
18 deliberately?

19                   MR. BELL: No, most definitely not, no.  
20 As far as this whole question of the financial  
21 intermediaries is concerned, I think that here a very  
22 careful inquiry and study should be made to find out  
23 what are the suitable controls that would permit  
24 the monetary authorities to exercise the kind of  
25 influence over them as they now exercise over the  
26 chartered banks. This may be very difficult to work  
27 out controls on. I am not suggesting for one moment  
28 it is easy, but at the same time unless these inter-  
29 mediaries are brought under the control of the central  
30 bank -- and I say the central bank deliberately because



of the position that has been taken by some of them --  
and this is indirect, I haven't heard the exact  
testimony that they offered to you -- but that is  
that if it is found that credit unions do have a  
considerable effect on monetary policy, then perhaps  
some ways and means might have to be devised to bring up  
under some regulation, but I think the point that they  
would make is that the kind of regulation or the kind  
of regulatory power imposed on credit unions might be  
very considerably different from other financial  
institutions because of the basic difference in their  
nature.

COMMISSIONER BROWN: I think you define  
their operations quite succinctly in paragraph 88:  
it seems to fit into your definition of the other near  
banks, but do I gather that you are not counting them  
collaboratively?

MR. BELL: No, most definitely not, no.  
as far as this whole question of the financial  
intermediaries is concerned, I think that here a very  
general inquiry and also should be made to find out  
what are the reliable controls that would permit  
the monetary authorities to exercise the kind of  
influence over them as they now exercise over the  
chartered banks. This may be very difficult to work  
out controls and I am not suggesting for one moment  
it is easy, but at the same time unless these inter-  
mediaries are brought under the control of the central





1 I think it is more properly concerned with the central  
2 bank than any other institution -- then it seems to  
3 me that as these intermediaries grow and expand  
4 that it is going to be that much more difficult to  
5 implement monetary policy by the central bank  
6 authorities. I don't see why these intermediaries  
7 should be any more privileged than the chartered  
8 banks, for example.

9 I realize, of course, that there are  
10 very basic differences in the functions of the two,  
11 but at the same time the fact that they do exert  
12 considerable influence, I think, on prices and output,  
13 would suggest that they should be brought under  
14 regulatory control, as is and has been the case with  
15 the chartered banks for many years.

16 COMMISSIONER BROWN: In paragraph 84  
17 you refer to the Bank of Canada maintaining low  
18 interest rates by supporting government bond prices,  
19 and you say that the inflationary effects could be  
20 avoided by changing the cash reserve requirements  
21 of the chartered banks?

22 MR. BELL: Yes.

23 COMMISSIONER BROWN: I can see that you  
24 could offset the multiplier effect of the cash  
25 reserves, but it would seem difficult to avoid at  
26 least the one for one increase in the money supply,  
27 and in any case I was wondering why you would choose  
28 that way of doing it rather than just a modest  
29 increase in the reserve, to have the same  
30 effect?



I think it is very important to remember that it is going to be that much more difficult to implement monetary policy by the central bank should be any more privileged than the chartered banks, for example.

I realize, of course, that there are very basic differences in the functions of the two, but at the same time the fact that they do exert considerable influence, I think, on prices and output, would suggest that they should be brought under regulatory control, as it has been the case with the chartered banks for many years.

COMMISSIONER BROWN: In paragraph 34 you refer to the Bank of Canada maintaining low interest rates by supporting government bond prices, and you say that the inflationary effects could be avoided by changing the cash reserve requirements of the chartered banks?

ANSWER: I can see that you could offset the multiplier effect of the cash reserves, but it would seem difficult to avoid at least the one for one increase in the money supply, and in any case I was wondering why you would choose that way of doing it rather than just a modest increase in the reserve, to have the same



1 MR. BELL: Well, if it was found desirable  
2 not to raise the cash reserves of the chartered banks --  
3 which, of course, would be the effect of the Bank  
4 of Canada's open market operations -- then this  
5 method of varying the cash reserve requirements and  
6 raising the cash requirements of the chartered banks,  
7 which the Bank of Canada has the power to do but it  
8 has never exercised, could be used to neutralize  
9 the effect that open market operations would otherwise  
10 have on the cash reserves of the chartered banks.

11 This is only a suggestion because it may  
12 not be necessary; it may not be necessary or even  
13 desirable, as a matter of fact, to restrain an increase  
14 in the cash reserves in the chartered banks. It all  
15 depends on the economic circumstances that prevail  
16 at that particular time.

17 COMMISSIONER GIBSON: It could accomplish  
18 the same result by permitting an increase in the  
19 cash reserves in the banks of one-tenth or one-twelfth  
20 of the amount of the additional money that is required;  
21 this is the normal way.

22 MR. BELL: It is the normal way and if it  
23 could be accomplished that way, then all right, but  
24 there seems to be a good deal of apprehension in many  
25 quarters that by maintaining lower interest rates  
26 through open market operations that this would be  
27 inflationary.

28 Now, if it would be inflationary, then  
29 it seems that this particular method of varying the  
30 cash reserve requirements as now provided by the law





MR. HILL: Well, it is not found desirable

not to raise the cash reserves of the chartered banks --  
which, of course, would be the effect of the Bank  
of Canada's open market operations -- then this  
method of varying the cash reserve requirements and  
raising the cash requirements of the chartered banks,  
which the Bank of Canada has the power to do, has  
has never exercised, could be used to neutralize  
the effect that open market operations would otherwise  
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not be necessary. It may not be necessary or even  
desirable, as a matter of fact, to increase an increase  
in the cash reserves in the chartered banks. It all  
depends on the economic circumstances that prevail  
at that particular time.

COMMISSIONER GIBSON: It would accomplish

the same result by permitting an increase in the  
cash reserves in the bank of one-half or one-twelfth  
of the amount of the additional money that is required;  
this is the normal way.

MR. HILL: It is the normal way and it is

could be accomplished that way, then all right, but  
there seems to be a good deal of apprehension in many  
quarters that by maintaining lower interest rates  
through open market operations that this would be

Now, if it were to be maintained, then

it seems that this particular method of varying the  
cash reserve requirements as now provided by the law



1 might very well have a beneficial effect in restraining  
2 increase  
3 any undesirable/in the cash reserves of the chartered  
4 banks.

5 COMMISSIONER GIBSON: But if you did it without  
6 increasing the cash reserves you would have an offsetting  
7 deflationary factor and you wouldn't do the job?

8 MR. BELL: Well, all we are suggesting here  
9 is that here is an available technique if circumstances  
10 warrant its use, and if it is not necessary for it  
11 to be used, then obviously there would be no point  
12 in using it.

13 COMMISSIONER BROWN: But if the central bank  
14 is going to buy some bonds, X number of bonds, is not  
15 at least  
16 the result going to be /this amount of additional money  
17 in the system?

18 MR. BELL: If the Bank of Canada goes into  
19 the open market and buys government bonds, then the  
20 normal result is for an increase in the cash reserves  
21 of the chartered banks.

22 Now, if the Bank of Canada's purpose in going  
23 into the open market is simply to support government  
24 bond prices, but doesn't want the normal result  
25 of an increase in the cash reserves on the chartered  
26 banks, then it could to a certain extent prevent  
27 that increase simply by raising the reserve requirements  
28 of the chartered banks. Is that not right?

29 COMMISSIONER BROWN: You have a one for one  
30 increase.

COMMISSIONER GIBSON: That is technically  
so, but you still add the amount of the government

bank.





1 purchase of bonds to the money supply?

2 MR. BELL: But you would prevent the  
3 multiple effects.

4 COMMISSIONER BROWN: I don't understand  
5 that part in that paragraph where you refer to  
6 increasing these reserve requirements; I would have  
7 thought it would be the other way around?

8 MR. BELL: Which paragraph is that?

9 COMMISSIONER BROWN: It is in paragraph 85.  
10 At the moment the leverage is  $12\frac{1}{2}$  to one, and if  
11 you raise the requirement 10 per cent, then it is  
12 only 10 to one?

13 MR. BELL: I just don't see any point,  
14 as a matter of fact, in taking a ceiling of 12 per  
15 cent; I don't think that this is necessary at all.  
16 It is very important that there be a minimum reserve  
17 requirement which is fixed at 8 per cent, but for  
18 the purposes of putting a ceiling on this it just  
19 doesn't suggest to me that -- well, it doesn't suggest  
20 to me that there is any need for it.

21 COMMISSIONER BROWN: But it doesn't do any  
22 harm having it ?

23 MR. BELL: No, except that occasions might  
24 arise when it might be necessary to exceed the 12  
25 per cent limit, and consequently I can't see that there  
26 should be any barrier put in the way of the Bank of  
27 Canada's operations.

28 COMMISSIONER BROWN: It was the use of the  
29 word "leverage" which I didn't understand. It seemed  
30 that the leverage got less.



COMMISSIONER BROWN: I don't understand

that part in that paragraph where you refer to  
increasing these reserve requirements. I would have

thought it would be the other way around.

MR. BELLE: Where mentioned in that

At the moment the leverage is 125 to one, and if

you raise the requirement to 10 per cent, then it is

only 10 to one.

MR. BELLE: I don't see any point,

as a matter of fact, in raising a ceiling of 12 per

cent; I don't think that is necessary at all.

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the purposes of putting a ceiling on this is just

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MR. BELLE: No, except that occasionally might

arise when it might be necessary to exceed the 12

per cent limit, and consequently I don't see that there

should be any barrier put in the way of the bank or

Canada's operations.

COMMISSIONER BROWN: It was the use of the

word "leverage" which I didn't understand. It seemed

over the leverage was taken.



1 MR. BELL: No, we don't mean it that way.  
2 Actually, "flexibility" is the word that should be  
3 used there.

4 COMMISSIONER MacKEEN: I just have a few  
5 questions, Mr. Chairman. First in regard to the  
6 recommended changes in the Bank of Canada Act,  
7 paragraph 113, and in the first recommendation you  
8 say, "and to promote full employment"; that is in  
9 the preamble.

10 Now, we have heard various experts from  
11 central banks, and some expressed one objective and  
12 some another, and they all mention the same purposes;  
13 full employment was one and in another case it might  
14 be the soundness of the currency and another one  
15 might be on exchange, and so on. What have you in mind  
16 that would reflect the objective of the bank to the  
17 substitution in the preamble?

18 MR. BELL: All we are suggesting here is  
19 that in the preamble to the Act that the words full  
20 employment should be inserted because they are  
21 not there now. In other words, the preamble sets up  
22 the objectives of national policy, and we simply  
23 think that full employment should be included as  
24 one of those objectives. In other words, we want to  
25 give emphasis to this point, and that is our reason  
26 for making this suggestion.

27 COMMISSIONER MacKEEN: On the second  
28 recommendation you mention three alternatives. What  
29 does the Congress consider the possible alternative  
30 there?





MR. CHAIRMAN: I have a question to ask.

Actually, "flexibility" is the word that should be used there.

COMMISSIONER MACKENZIE: I just have a few

questions, Mr. Chairman. First in regard to the

recommended changes in the Bank of Canada Act,

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not there now. In other words, the preamble sets up

the objectives of national policy, and we simply

think that full employment should be included as

one of those objectives. In other words, we want to

give emphasis to this point, and that is our reason.

COMMISSIONER MACKENZIE: On the second

recommendation you mention those alternatives. What

does the Government consider the possible alternatives



1 MR. BELL: Well, we haven't taken any  
2 position on this; we have simply suggested three  
3 possibilities for removing the governor or deputy  
4 governor, and the reason why we have done so is simply  
5 to avoid the kind of difficulties that were experienced  
6 about a little over a year ago when this unfortunate  
7 situation arose.

8 COMMISSIONER MacKEEN: The conditions under  
9 which they might be removed should be defined?

10 MR. BELL: Precisely, that is the main  
11 purpose; that whatever moving is considered to be  
12 best, that it should be carefully defined.

13 COMMISSIONER MacKEEN: You should have a  
14 fairly wide scope of authority?

15 MR. BELL: Definitely.

16 COMMISSIONER MacKEEN: Now, coming to the  
17 functions of the board of directors. What do you  
18 visualize is the proper function of the board of  
19 directors?

20 MR. BELL: Here we have in mind that because  
21 the Bank of Canada is an exceedingly important public  
22 institution that it should have -- and I am not for  
23 one moment casting any reflections on the present  
24 members of the board of directors at all -- but I  
25 think or we think that appointments to the board  
26 should consist of people who are highly qualified in  
27 monetary economics and should have considerable  
28 financial experience because the Bank of Canada or the  
29 central bank of our country is an exceedingly important  
30 one and therefore it should be staffed by only the most



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monetary economics and should be considerable

financial experience because the Bank of Canada or the  
general bank of our country is an exceedingly important  
one and therefore it should be staffed by only the most





1 competent people available.

2 COMMISSIONER MacKEEN: I presume that  
3 the constitution of the present board is based to  
4 some extent on geographical selection and also that  
5 the selection is made with the broad business outlook  
6 available to management in Canada. Do you think it  
7 should be more on the basis of technical knowledge  
8 of monetary policies than anything else?

9 MR. BELL: I think that there should be  
10 more emphasis -- that is the word which I would like  
11 to use here -- I think there should be more emphasis  
12 given to appointing people who are highly qualified  
13 and competent in monetary economics which, of course,  
14 is what the Bank of Canada is all about.

15 COMMISSIONER MacKEEN: Do you see any  
16 possibility of a board largely composed of experts  
17 and they might disagree on policy matters and occasion  
18 some embarrassment to the Department of Finance?

19 MR. BELL: This is always quite possible, sir;  
20 it is quite possible, yes.

21 COMMISSIONER MacKEEN: Pardon?

22 MR. BELL: It is certainly quite possible.  
23 As long as human nature is involved there is always  
24 going to be a certain disagreement with respect to  
25 views, but we feel that the composition of the board  
26 should lean more in the direction of expertise; the  
27 highly complex and intricate problems that the Bank of  
28 Canada and the central bank has to face would seem  
29 to warrant that conclusion.

30 COMMISSIONER MacKEEN: From what fields

COMMISSIONER MACKENZIE: I think that the constitution of the present board is based to some extent on geographical selection and also that the selection is made with the broad business outlook available to management in Canada. Do you think it should be more on the basis of technical knowledge of monetary policies than anything else?

MR. BELL: I think that there should be more emphasis -- that is the word which I would like to use here -- I think there should be more emphasis given to appointing people who are highly qualified and competent in monetary economic matters, of course, is what the Bank of Canada is all about.

COMMISSIONER MACKENZIE: Do you see any possibility of a board largely composed of experts and they might disagree on policy matters and occasion some embarrassment to the Government of Finance?

MR. BELL: This is always quite possible, isn't it? It is quite possible, yes.

MR. BELL: It is certainly quite possible, as long as human nature is involved there is always going to be a certain disagreement with respect to views, but we feel that the composition of the board should lean more in the direction of expansion; the highly complex and technical problems that the Bank of Canada and the central bank has to face would seem to warrant that composition.

COMMISSIONER MACKENZIE: From what fields



1 would you choose such people?

2 MR. BELL: Well, one of the obvious  
3 ones, of course, would be highly competent economists,  
4 particularly those with special training in monetary  
5 economics. I am not suggesting for one moment that  
6 the entire board consist of professorial types, but  
7 only those in a particular field.

8 COMMISSIONER MacKEEN: If you arrive  
9 at that solution you may get an even greater degree  
10 of diversion.

11 MR. BELL: No, all I am suggesting or  
12 all that we are suggesting here is that there should  
13 be a bit more emphasis given to the expertise side;  
14 that these very intricate problems facing the central  
15 bank really require that.

16 COMMISSIONER MacKEEN: Thank you very  
17 much.

18 COMMISSIONER HARROLD: I have just one  
19 or two questions on this section, Mr. Chairman, and  
20 this has to do with your fourth recommendation where  
21 you say that the Act should provide that the final  
22 responsibility for monetary policy clearly rests  
23 with the Minister of Finance. Do you see any  
24 difficulty about this interference that you mention  
25 in the way that you do when you say that it is hardly  
26 necessary to ask that the Congress does not want to  
27 see the Bank become a department of government.  
28 Have you any suggestions as to how safeguards may  
29 be written into the Act to see that this doesn't  
30 happen?



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COMMISSIONER MCKINLEY: Thank you very

much.

COMMISSIONER HANCOCK: I have just one

or two questions on this section, Mr. Chairman, and

this has to do with your fourth recommendation where

you say that the Act should provide that the final

recommendation of the Monetary Board shall be

with the Minister of Finance. Do you see any

difficulty about this in reference that you mention

in the way that you do when you say that it is hardly

necessary to ask that the Congress does not want to

see the Bank become a department of Government.

Have you any suggestions as to how amendments may

be written into the Act to see that this doesn't

happen?



1 MR. BELL: I would think this would be  
2 very, very difficult to do. The reason we make this  
3 point here, again, is to try to avert a repetition  
4 of the situation that has taken place. We have had  
5 two Ministers of Finance now who have attempted to  
6 disclaim responsibility for monetary policy, and in  
7 our view this just does not make sense. The Minister  
8 of Finance has to accept ultimate responsibility for  
9 monetary policy, the same as he accepts, or he and  
10 his government accept, ultimate responsibility for  
11 fiscal policy. If the Minister of Finance attempts  
12 to shove off the responsibility to the Governor of  
13 the Bank of Canada for any monetary policy, as the  
14 recent Ministers of Finance attempted to do , then  
15 the Minister of Finance is actually <sup>saying</sup> that public policy  
16 carried out by the Bank of Canada is the sole  
17 responsibility of the Bank of Canada and not the  
18 responsibility of the elected representatives in  
19 Parliament.

20 This is certainly a most undemocratic thesis  
21 to lay down, in my opinion. Furthermore, from a purely  
22 practical point of view it is just unworkable, for  
23 fiscal policy and monetary policy must work in harmony,  
24 and if the Minister of Finance is going one way and  
25 the Governor of the Bank of Canada is going another  
26 way, then obviously the system is just going to break  
27 down. Fiscal policy will be thwarted, as it has been  
28 when a monetary policy is carried out in another  
29 direction.

30 COMMISSIONER HARROLD: You do not see, then,



MR. HART: I would think this would be

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way, then obviously the system is just going to break

down. Fiscal policy will be thwarted, as it has been

when a monetary policy is carried out in another

MINISTER HART: You do not see, then,





1 any difficulty in arriving at a balance be  
2 how independent the Bank should be or whether  
3 should not be independent and directly responsible  
4 to the Minister?

5 MR. BELL: I do not believe there is any  
6 particular difficulty and I do not think, as a matter  
7 of fact, these things should be spelled out. I think  
8 you would really create difficulties if you attempted  
9 to spell out in a detailed way the exact responsibilities  
10 of the Governor of the Bank of Canada in relation  
11 to the Minister of Finance. After all, we had in  
12 this country, I think for many years, a pretty close  
13 co-operation between the Bank of Canada and the  
14 government. Events seemed to go along pretty smoothly,  
15 unless, of course, there were certain things going  
16 on behind the scenes which I was not aware of. That  
17 may have been so, but I do not think so. Again I  
18 think this is a matter of developing through  
19 pragmatic experience a working relationship between  
20 the central bank on the one hand and the government  
21 on the other. But when all is said and done, only  
22 the government can accept ultimate responsibility  
23 for the monetary policy, for only the government is  
24 an elected body. The Governor of the Bank of Canada  
25 is not an elected official.

26 COMMISSIONER HARROLD: Have you given any  
27 thought to a system of directives, which is permissible  
28 under the British system? Do you think it would serve  
29 any useful purpose here? In other words, if a difference  
30 of opinion should arise between the Minister of



any difficulty in arriving at a balance would be

how independent the Bank should be or whether or not this

should not be independent and wholly responsible

to the Ministers?

MR. BELL: I do not believe in a

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on the other. But when all is said and done, only

the Government can accept ultimate responsibility

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an elected body. The Governor of the Bank of Canada

is not an elected official.

COMMISSIONER HARROLD: Have you given any

thought to a system of advisory, which is

under the British system, in which the

any such purpose seems to be

or obtain similar advice



1 Finance and the Governor of the Bank of Canada, do  
2 you think it would be a good thing to have a system  
3 of directives by which the Minister of Finance could  
4 either publicly or otherwise direct the Governor  
5 of the Bank to do certain things in the way of a  
6 monetary policy?

7 MR. BELL: I am going to refer to what a  
8 former Governor of the Bank of Canada had to say on  
9 this matter. This was before the House of Commons  
10 Standing Committee on Banking and Commerce during  
11 the decennial revision of the Bank of Canada Act  
12 in 1954. The then Governor of the Bank of Canada,  
13 Mr. Towers, was asked what would happen in the event  
14 of a conflict between himself and the Minister of  
15 Finance. His answer was quite forthright and very  
16 acceptable. He said that in the event of a conflict  
17 between himself and the Minister of Finance, or the  
18 government, on policy, either he would have to reconcile  
19 to their policy or he would have no alternative but  
20 to resign. If the Governor cannot carry out government  
21 policy, then I think he simply has to resign because  
22 after all he is not ultimately responsible for  
23 government policy; only the government can be.

24 COMMISSIONER HARROLD: There is just one  
25 more question, and that has to do with the suggestion  
26 that the Bank of Canada Act should itself provide a  
27 periodic and more frequent revision of the Bank of  
28 Canada Act.

29 If there is felt a great need for this,  
30 there is nothing in the present Act which prohibits





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If there is felt a great need for this,

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1 amendments being made at any time that it may seem  
2 necessary to have them made. But do you think that  
3 a periodic revision of this kind would be more  
4 acceptable or provide a more definite benefit than the  
5 present system in which an amendment can be brought  
6 in, I presume, at any session of Parliament?

7 MR. BELL: Here we have in mind the very  
8 speed at which events take place now and the consequent  
9 need for reviewing matters at more frequent intervals.  
10 As a matter of fact, we think such things as the  
11 decennial revision of the Bank of Canada Act,  
12 and Royal Commissions such as yours, besides serving  
13 the purpose of making recommendations with respect  
14 to policy, serve an extremely important function in  
15 providing public education and promoting public  
16 education on this most important and, at the same  
17 time, difficult field. Consequently, the more airings  
18 of these matters there are, the better informed  
19 the Canadian public is likely to become.

20 Therefore, these things serve more than  
21 just the purpose of bringing about necessary revisions  
22 in Acts, or in having policy recommendations made.  
23 They also serve the extremely important function of  
24 education.

25 COMMISSIONER HARROLD: You suggest something  
26 less than 10 years. Can you be more specific? Would  
27 you suggest 5 years, 6 years?

28 MR. BELL: I do not think it is very important  
29 to specify it here, but I think that it should be  
30 less than every ten years. Ten years is far too long



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...necessary to have them made. But do you think that  
a periodic revision of this kind would be more  
acceptable or provide a more definite benefit than the  
present system in which an amendment can be brought  
in, I presume, at any session of Parliament?  
MR. BELL: Now we have in mind the very  
speed at which even a single bill and the consequent  
need for reviewing matters at more frequent intervals.  
As a matter of fact, we think such things as the  
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COMMISSIONER HANCOCK: You suggest something  
less than 10 years. Can you be more specific? Would  
you suggest 5 years, 6 years?

MR. BELL: I do not think it is very important





1 now. Too many things take place in a period of a  
2 decade. Every five years might be quite feasible,  
3 but certainly something less than ten years.

4 COMMISSIONER LEMAN: Not with a Royal Commission  
5 every five years?

6 MR. BELL: No.

7 THE CHAIRMAN: Thank you very much, gentlemen,  
8 for a very useful discussion. I hope we have not  
9 exhausted you, Mr. Bell. You have answered the  
10 questions in great detail and in a most helpful way.  
11 We appreciate very much you presenting your brief  
12 and being with us today. I can only say that we are  
13 extremely gratified at the views we have obtained  
14 from you this morning.

15 MR. MacDONALD: My Lord Chief Justice,  
16 and gentlemen, on behalf of the Congress I want to  
17 express our appreciation of the courtesy and attentive  
18 hearing you have given us. We have been very favourably  
19 impressed with the penetrating and pertinent questions  
20 that have gone on, and we trust that the amplification  
21 of our submission which has resulted will be reflected  
22 in your eventual report.

23 THE CHAIRMAN: We shall adjourn now until  
24 9.15 tomorrow morning when we shall hear submissions  
25 from the Canadian Association of Consumers, the  
26 Canadian Exporters' Association, and Professor E.T.  
27 Neufeld.

28 --- Adjournment.  
29  
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# Royal Commission on Banking and Finance

THE CANADIAN LABOUR CONGRESS

Hearings  
held at  
OTTAWA

Vol.

47A

Date.

October 24, 1962



Official Reporters  
F. J. Pethercut and R. J. Young  
Toronto, Ont.







*Nethercut & Young*  
*Toronto, Ontario*

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THE SUBMISSION OF  
THE CANADIAN LABOUR CONGRESS

TO THE  
ROYAL COMMISSION ON BANKING AND FINANCE

1962



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THE HISTORY OF

THE CANADIAN LABOUR CONGRESS

1900

ROYAL COMMISSION ON BANKING AND FINANCE





S U M M A R Y

(The Canadian Labour Congress, the main Canadian central labour organization, with a membership of over 1,000,000 is located at 100 Argyle Avenue, Ottawa, Ontario.)

1. Monetary and fiscal policies, properly coordinated, can play a dynamic role in promoting full employment and adequate economic growth.

2. While monetary policy by itself is limited in what it can achieve, non-monetary measures for stimulating economic growth will usually be dependent on, often impossible without, an appropriate expansion of the money supply. Monetary policy and fiscal policy must supplement each other.

3. Neither private capital investment nor exports can be relied upon to restore full employment and the pre-1957 economic growth rate.

4. The slow-down of our economy can be corrected only by appropriate fiscal and monetary policies. What is required is a massive expansion in the public sector of the economy, which, by comparison with the private sector, has been seriously neglected. By the "public sector" we mean goods and services which governments (national, provincial and municipal) invest in: slum clearance and urban redevelopment, public development and conservation of resources, housing, hospitals, schools, provincial universities, technological and scientific institutions, roads and many other things essential to



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1 any advanced society.

2 5. "Expansion in the public sector", does not  
3 mean makeshift public works programmes, but a planned,  
4 long-term, sustained expansion of social capital, public  
5 services, and investment in the most important capital  
6 of all, human capital. Meeting these needs would at  
7 the same time go a long way towards solving our employ-  
8 ment problem.

9 6. Investment in the public sector provides an  
10 important stimulus to the private sector through the  
11 multiplier effect. Consequently, the initial public  
12 investment not only increases demand for goods and  
13 services to satisfy social needs, but also, indirectly,  
14 for goods and services to satisfy individual consumer  
15 needs. Business investment is thus stimulated by  
16 individual and collective demands.

17 7. This is not possible without effective co-  
18 ordination between monetary and fiscal policies. At  
19 present, with unused economic capacity, a carefully planned  
20 deficit budget will be required, supported by an appropriate  
21 expansion of the money supply.

22 8. In an economy with unused resources, borrowing  
23 by expanding credit is not inflationary. The new credit  
24 would be employed to put such idle resources to work.  
25 The increase in purchasing power would be offset by a  
26 real increase in the gross national product. Inflation  
27 will result only if deficit financing is continued  
28 after full employment has been achieved. (Some may  
29 object that such policies are inappropriate in view of the  
30 recent changes in exchange rate policy. See below.)





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after full employment has been achieved. (Some may

object that such policies are inappropriate in view of the

recent changes in exchange rate policy. See below.)



1 9. In the past there has been too much reliance  
2 on general monetary controls to combat inflationary pressures  
3 which did not result from excessive general demand. The  
4 Bank of Canada has, for example, applied a tight money  
5 policy to curb inflationary pressures brought on by  
6 excessive private capital spending. The effect on such  
7 spending is negligible because corporations depend  
8 largely on internally generated funds for capital  
9 investment. But tight money and high interest rates  
10 have substantial adverse effects on provincial and  
11 municipal governments, and other public bodies which  
12 raise loans in the capital market; smaller business,  
13 which must invariably rely mostly on bank credit; and  
14 homebuilders for whom even a small increase in mortgage  
15 rates means an appreciable addition to costs.

16 10. The answer to specific inflationary pressures  
17 is selective, not general, monetary controls. One  
18 selective control with distinct possibilities for regulating  
19 corporate spendings is a variable depreciation rate.  
20 Another is the licensing of large capital issues.

21 11. The Bank of Canada should assume an active  
22 role with respect to interest rates. A central bank  
23 which does not accept the responsibility of positive  
24 guidance and influence on the level of interest rates  
25 is failing to fulfil one of its primary functions, the  
26 regulation of the cost of money in accordance with  
27 economic requirements.

28 12. A fixed Bank Rate would usefully supplement  
29 open market operations by indicating the kind of monetary  
30

12. A fixed Bank Rate would usually supplement open market operations by indicating the kind of monetary economic requirements.

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1 policy the Bank believed appropriate.

2 13. ~~successful~~ A major weakness in our financial system is  
3 the fact that financial intermediaries such as instalment  
4 finance companies, personal loan companies, trust and  
5 loan companies and others, are not subject to any kind  
6 of monetary control. Unless some control over these  
7 institutions is co-ordinated with control over the banking  
8 system, monetary policy will become increasingly less  
9 effective.

10 14. Recent changes in exchange rate policy have  
11 particular significance for monetary policy. We are  
12 especially apprehensive that a fixed exchange rate will  
13 make it difficult for Canada to pursue expansionary monetary  
14 and fiscal policies necessary to achieve full employment  
15 and suitable economic growth rates.

16 15. ~~For Canada~~ For Canada, with its comparatively large  
17 external transactions, a free exchange rate is preferable.  
18 It helps adjust our balance of international payments  
19 to meet our domestic needs. With a fixed exchange rate,  
20 domestic policies which may actually promote unemployment  
21 and low growth rates may be adopted because they are  
22 considered essential to balance of payments requirements.

23 16. ~~The present~~ The present balance of payments problem  
24 really underlines the need for a free exchange rate.  
25 With a free rate, and positive policies to stimulate  
26 exports of goods and services, our present external  
27 difficulties could be greatly reduced and there would  
28 be no need to employ either long-term external or internal  
29 restrictive policies.

30 17. ~~Somehow~~ Somehow we must increase our exports of goods



13. A major weakness in our financial system is the fact that financial intermediaries such as insurance finance companies, personal loan companies, trust and loan companies and others, are not subject to any kind of monetary control. Unless some control over these institutions is co-ordinated with control over the bank system, monetary policy will become increasingly less effective.

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17. Somehow we must increase our exports of goods



1 to compensate for recurring deficits on "invisibles".  
2 Careful consideration should be given to measures to boost  
3 merchandise exports, e.g., export subsidies, further  
4 improvement in export credit facilities, and tax  
5 incentives to firms which exceed certain export quotas.

6 18. ~~and can~~ There may also have to be important changes  
7 in the structure of some secondary industries, where  
8 there are too many firms operating in a comparatively small  
9 market, which only results in unnecessary inefficiencies.

10 19. ~~Canada~~ The tourist industry could be improved to  
11 attract foreign tourists to Canada and to encourage  
12 Canadian tourists to do more of their travelling inside Canada.

13 20. ~~But even~~ But even with such measures, we still doubt  
14 whether, with a fixed exchange rate, Canada can avoid  
15 serious balance of payments problems in the future. The  
16 best policy for Canada is to get back to a floating rate.  
17 The next best is to get the International Monetary  
18 Fund rules changed to allow the rates to fluctuate within  
19 appreciably wider limits. But if we can neither get  
20 back to a floating rate, nor get a more flexible fixed  
21 rate, then we must press hard for new international  
22 monetary arrangements which will provide for far greater  
23 international liquidity.

24 21. ~~Canada~~ Canada alone cannot change the present  
25 inadequate international liquidity arrangements. But,  
26 if you feel unable to recommend either outright return  
27 to a floating rate, or a more flexible fixed rate, then it  
28 becomes imperative for you to consider carefully what  
29 policy Canada should adopt towards the various plans for  
30 greater international liquidity, and to make recommendations





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1 accordingly. Such recommendations could then serve  
2 as a basis for Canadian proposals in the international  
3 negotiations on this subject which cannot be much longer  
4 postponed.

5 22. The following changes should be made in the  
6 Bank of Canada Act:

7 (a) The preamble should be amended by inserting, after  
8 the words "prices and employment" in the sixth  
9 line, the words, "and to promote full employment".

10 (b) Section 6 (3) (a) should be amended to make clear  
11 the precise procedure to be followed in removing  
12 the Governor or Deputy Governor. If it is con-  
13 sidered necessary to place the Governor and Deputy  
14 Governor beyond the reach of dismissal by the Govern-  
15 ment, the paragraph should be amended by adding  
16 the words, "but may be removed from office at any  
17 time by the Governor General, on Address of the  
18 Senate and House of Commons." If it is felt that  
19 the Governor and Deputy Governor should not be placed  
20 in so independent a position, then the paragraph  
21 might be amended by adding the words, "but may be  
22 removed for cause at any time by the Governor in  
23 Council", or "may be removed by the Governor in  
24 Council for misbehaviour or incapacity, inability  
25 or failure to perform his duties properly".

26 (c) Steps should be taken to make the Board of Directors  
27 really effective, which it does not appear to be now.  
28 This may not require any amendment, (though we  
29 think it should be specified that a due proportion  
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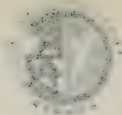


1 experience or special knowledge in the field of  
2 monetary economics), but it might well require a  
3 change of Government policy.

4 (d) The Act should distinctly provide that final  
5 responsibility for monetary policy rests with the  
6 Minister of Finance.

7 (e) The Auditor-General should be designated as the  
8 Bank's auditor.

9 (f) The Bank of Canada Act should itself provide for  
10 periodic, and fairly frequent, revision.  
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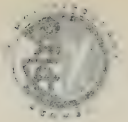
1 My Lord Chief Justice and Members of the Commission:

2 1. The Canadian Labour Congress, which was one  
3 of the bodies asking for the appointment of this  
4 Commission, welcomes the opportunity to appear before  
5 you and to present its views. The operations of monetary  
6 and financial institutions have an important bearing  
7 on two matters which greatly concern the labour movement,  
8 namely, employment and economic growth (with reasonable  
9 price stability).

10 2. During the past five years Canada has  
11 experienced high rates of unemployment and low rates of  
12 economic growth. Furthermore, there does not appear to  
13 be any prospect of more than a temporary improvement in  
14 this situation. It is fitting, therefore, that an  
15 inquiry of this kind be undertaken to see how financial  
16 and monetary policies can best contribute to reversing  
17 these economic trends. Monetary policy cannot, of  
18 course, be considered adequately apart from fiscal and  
19 other policies and we shall, therefore, have something  
20 to say about the latter as well.

21 3. You have been appointed to "enquire into and  
22 report upon the structure and methods of operation of  
23 the Canadian financial system, including the banking and  
24 monetary system and the institutions and processes  
25 involved in the flow of funds through the capital market",  
26 and to "make recommendations (i) for the improvement of  
27 the structure and operations of the financial system and,  
28 more particularly, (ii) concerning the Bank Act, the  
29 Bank of Canada Act, the Quebec Savings Banks Act, and  
30 other relevant federal legislation".





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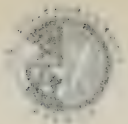
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2 the Bank Act or the Quebec Savings Bank Act, nor, except  
3 incidentally, about the operations of the chartered  
4 banks and the Quebec Savings Banks. It will confine its  
5 presentation to the broad, general questions before you,  
6 and to certain suggestions for amendments to the Bank  
7 of Canada Act.

8 5. You have indicated that you would like the  
9 Congress to provide information on "the activities of  
10 unions as borrowers and lenders in the capital market;  
11 the reasons for which unions borrow and the sources of  
12 funds open to them; the forms in which unions invest  
13 funds which they have accumulated; the ways in which  
14 borrowing and investment policy is influenced by credit  
15 conditions."

16 6. Answers to these questions can be almost as  
17 brief as the famous chapter on the snakes in Ireland.

18 7. The Congress has almost no information on the  
19 subject, and no means of getting it except by sending out  
20 questionnaires to its hundred or so affiliated unions, a  
21 process which would involve the small staff of the  
22 Research Department in an almost infinite series of follow-  
23 up letters and an appallingly time-consuming analysis of  
24 such information, probably meagre, as might be received.  
25 Anything like full information on the subject will become  
26 available only with the publication of the statistics  
27 to be provided by corporations and unions under the Act of  
28 last session.

29 8. By and large, unions neither borrow nor lend.  
30 When they borrow, it is almost always small amounts on



4. The Congress will have nothing to say about the Bank Act or the Quebec Savings Bank Act, nor, except incidentally, about the operations of the chartered banks and the Quebec Savings Banks. It will confine its presentation to the broad, general questions before you, and to certain suggestions for amendments to the Bank of Canada Act.

5. You have indicated that you would like the Congress to provide information on "the activities of unions as borrowers and lenders in the capital market; the reasons for which unions borrow and the sources of funds open to them; the forms in which unions invest funds which they have accumulated; the ways in which borrowing and investment policy is influenced by credit conditions."

6. Answers to these questions can be almost as brief as the famous chapter on the snakes in Ireland. The Congress has almost no information on the subject, and no means of getting it except by sending out questionnaires to its hundred or so affiliated unions, a process which would involve the small staff of the Research Department in an almost infinite series of follow letters and an appallingly time-consuming analysis of such information, probably meagre, as might be received. Anything like full information on the subject will become available only with the publication of the statistics to be provided by corporations and unions under the Act last session.

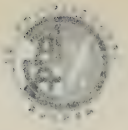
8. By and large, unions neither borrow nor lend. When they borrow, it is almost always small amounts on





1 short term by bank overdraft. When they lend, it is  
2 almost always a matter of bank deposits and Government  
3 bonds. For instance, at December 31, 1961, the Congress  
4 itself (which is not, of course, a "union" but a federation  
5 of unions) had no bank loans at all, its only debts being  
6 cheques outstanding (covered almost four times over by  
7 bank deposits), commissions payable, amounts due to the  
8 International Confederation of Free Trade Unions, the  
9 Chartered Union Defence Fund, and "dues suspense" (\$55.00).  
10 Its total liabilities to the public were considerably less  
11 than its bank deposits. Its investments were \$309,668.16  
12 in Dominion of Canada bonds, and one share (\$100.00) in  
13 the Atlantic Broadcasting Corporation. There is so  
14 little union borrowing and investment, and what there is is  
15 so nearly involuntary (since unions borrow only in dire  
16 need, and invest only their usually modest surplus  
17 revenues) that there is really no "borrowing and invest-  
18 ment policy" for credit conditions to have any effect  
19 on. This whole subject would seem to be a prime case  
20 for the maxim, "Lex de minimis non curat." (Congress  
21 financial statement attached.)

22 9. You have also indicated that you would like  
23 the Congress to provide "information on pension and wel-  
24 fare plans operated for union members; the growth of  
25 such funds and probable future trends; a description of  
26 the various arrangements for the management of such funds  
27 and the location of investment responsibility; changes in  
28 this regard and the reason for such changes; the rates of  
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President, United

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1 disposition of their investments among various classes of  
2 assets; . . . the adequacy of control of pension fund  
3 investment and administration."

4 10. . . . This also is a subject on which the Congress  
5 cannot provide much information.

6 11. . . . Very few unions have pension or welfare plans  
7 of their own in Canada. Some old, established  
8 international craft unions have such plans, but they do  
9 not differentiate between American and Canadian members;  
10 and again, the Congress could secure information on them  
11 only by an elaborate, time-consuming, and probably very  
12 unproductive process. Here, also, the legislation of  
13 last session may, in due course, produce figures which  
14 at present are not available at all.

15 12. . . . Most pension and welfare plans for union  
16 members arise out of collective bargaining. The Congress  
17 has about 3,500 collective agreements on file, but the  
18 kind of analysis of them which you would like is  
19 altogether beyond the resources of the Research Depart-  
20 ment, and even if it were not, the coverage is so spotty  
21 that any results would be of very dubious value. The  
22 Dominion Department of Labour may be in a position to give  
23 pretty full information on the subject. Its files are  
24 much more complete, and its staff very considerably  
25 larger, to put it mildly.

26 13. . . . Broadly speaking, it may be said that pension  
27 funds provided for under collective bargaining (and,  
28 incidentally, any pension or welfare funds so provided  
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1 Annuities, or insurance company funds. The Dominion  
2 Government Annuities are, of course, managed by the  
3 Annuities Branch of the Department of Labour, the  
4 insurance funds by the insurance companies concerned.  
5 Sometimes the employer pays the whole cost, sometimes the  
6 employees contribute. With the Annuities Branch, only  
7 the employer can contract; but with the insurance companies  
8 joint employer-union contracts are possible, and in fact  
9 often exist.

10 14. The safety of pension fund investments is  
11 presumably adequately provided for by the Annuities Act  
12 and the various Insurance Acts. So is the soundness of  
13 administration. The adequacy of the pensions themselves,  
14 with the related questions of vesting and portability,  
15 is, of course, another matter, but one which is beyond  
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17 15. Welfare plans under collective agreements are  
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5 17. You have also indicated that the Congress'  
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14 18. We wish to make it clear at the outset that  
15 we believe that fiscal and monetary policies should play  
16 a dynamic role in promoting objectives of full employment  
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18 supported by an appropriate monetary policy, can be a  
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21 19. The Congress has repeatedly urged that  
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23 the slow-down of our economy. This does not mean reliance  
24 on monetary policy alone. Far from it. Monetary policy  
25 by itself is limited in what it can achieve.

26 20. Those who have advocated an active rather than  
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1 provide a high growth rate and full employment. We know  
2 of no responsible people who have ever suggested anything  
3 so naive.

4 21. While the volume of credit, and its satis-  
5 factory regulation by the Bank of Canada, are highly  
6 important in influencing demand in the economy, they are  
7 certainly not the only factors. An expansion of credit  
8 will not bring about full employment and suitable  
9 economic growth unless there is demand for the expanded  
10 credit. The depression years of the 1930's proved this  
11 beyond doubt, if it ever needed proving. An abundant  
12 supply of cheap money will obviously not encourage busi-  
13 ness to borrow if the latter cannot profitably employ  
14 additional funds.

15 22. But at the same time, non-monetary measures  
16 for stimulating economic growth will usually be dependent  
17 on, often impossible without, an appropriate expansion  
18 of the money supply. It is the volume of money supply  
19 together with the velocity of its circulation, or the  
20 rate at which the money supply is used, which determines  
21 the level of output in the economy. Those who question  
22 the value of monetary policy in lifting an economy from  
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24 only. The correct approach is to regard monetary  
25 policy and fiscal policy as indispensable supplements  
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27 23. Since 1957 total demand for goods and services  
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1 industries and perhaps in some service industries as well.  
2 24. Annual investment in the private sector of  
3 the economy has been, and still is, considerably below the  
4 post-war peak investment of 1957. This is understandable,  
5 because ever since the private capital investment boom of  
6 1955-1957, productive capacity has exceeded effective  
7 demand.

8 25. There are those who contend that all that is  
9 required to stimulate economic activity is to reduce the  
10 "high" corporate income tax. With so much unused  
11 industrial capacity, we find it difficult to accept the  
12 theory that corporate tax rates are primarily responsible  
13 for our inadequate economic growth. Exponents of this  
14 theory argue that "high taxes" are "drying up" private  
15 capital funds, and stifling incentives to private invest-  
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3 27. We should like to quote from a letter to the  
4 editor of the New York Times by Mr. Benjamin Eiriksson,  
5 President of the Iceland Bank of Development. Although  
6 his observations are on the economic situation in the  
7 United States, they are pertinent to our previous  
8 comments. Mr. Eiriksson states:

9 " The two most recent policy measures  
10 to improve the situation (unemployment in  
11 the U.S.): permission of faster depreciation  
12 and a tax allowance for new equipment, seem  
13 sensible measures in themselves, but hardly  
14 to have a bearing on the main problem.

15 Both measures aim at the same target:  
16 stimulation of industrial investment.  
17 Within limits sufficiently narrow, there  
18 would be nothing unsound with such an idea.  
19 But under present conditions in the United  
20 States the consequences must be increased  
21 unemployment.

22 There are expansionary forces at work  
23 in the American economy, but they are mostly  
24 directed 'inward,' i.e., toward increased  
25 efficiency. The autonomous purpose of the  
26 economic system of capitalism is not maximum  
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7 unwilling to face the hard fact that there is  
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9 of effective demand stand the consumers with  
10 their private needs and their various govern-  
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12 In my view, the stress is much too much  
13 on stimulation of demand through stimulation  
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17 Investment is a healthy thing only as long as  
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26 in total demand for goods and services in Canada cannot  
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1 application of appropriate fiscal and monetary policies.  
2 How? Demand can be increased either through personal  
3 income tax cuts, or through increased public investment.  
4 Either would result in unbalancing the budget. The object  
5 would be to allow the budget to remain unbalanced until idle  
6 resources were fully employed. Personal income tax cuts  
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8 sustain, demand to the degree necessary to attain full  
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10 There is no question that adequate public investment  
11 could attain these objectives.

12 29. The Congress has advocated a massive expansion  
13 in the public sector of the economy, which, by comparison  
14 with the private sector, has been seriously neglected.  
15 By the "public sector" we of course mean goods and  
16 services which governments (national, provincial and  
17 municipal) invest in: slum clearance and urban redevelop-  
18 ment, public development and conservation of resources,  
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21 and many other things highly essential to any advanced  
22 society.

23 30. When we speak of "expansion in the public  
24 sector", we are thus not speaking of makeshift public  
25 works programmes, of the kind which were hastily contrived  
26 to meet mass unemployment in certain countries in the  
27 1930's. What we are proposing is a planned, long-term,  
28 sustained expansion of our social capital, of our public  
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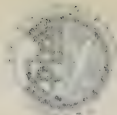




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3 31. Investment in the public sector provides, of  
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11 The result is a large and sustained increase in total  
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13 32. Such a programme is not possible, however,  
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18 How should the deficit be financed? There are some who  
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1 be spent there (obviously not an easy judgment to make),  
2 and how much must be borrowed from the banking system.  
3 An appropriate expansion of the cash reserves of the  
4 chartered banks will then be required to enable the  
5 latter to make the necessary credit available to the  
6 government. This, of course, cannot be done unless the  
7 central bank agrees to pursue an appropriate policy of open  
8 market operations.

9 33. Those who object to such a policy base their  
10 opposition largely on the ground that this would lead  
11 to inflation. It is important to examine this argument,  
12 because it constitutes the primary objection of most  
13 opponents to an unbalanced budget which must be financed  
14 in whole or in part, by an expansion of credit. Indeed,  
15 there are many who take for granted that financing  
16 government deficits by expanding credit will always  
17 cause inflation. Modern economic theory does not support  
18 such an assumption, and furthermore, it has been  
19 demonstrated time and again to be patently false in practice.  
20 In an economy that is not fully employed, an economy  
21 with idle manpower, unused plant capacity and idle  
22 resources, borrowing by expanding credit is not  
23 inflationary. Why? Because new credit would put these  
24 idle resources to work. The increase in purchasing power  
25 would be offset by a real increase in the gross national  
26 product. In other words, while additional money creates  
27 additional demand for goods and services, idle resources  
28 can be used to satisfy this additional demand. Hence,  
29 there is not likely to be any significant pressure  
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be spent there (obviously not an easy judgment to make), and how much must be borrowed from the banking system. An appropriate expansion of the cash reserves of the chartered banks will then be required to enable the latter to make the necessary credit available to the Government. This, of course, cannot be done unless the central bank agrees to pursue an appropriate policy of market operations.

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1 34. This is entirely different from the situation  
2 of a fully employed economy, where financing a deficit  
3 by expanding credit would only result in the creation  
4 of an additional demand for goods and services which, in  
5 the absence of idle resources, could not be produced until  
6 new resources became available. Thus, in this kind of  
7 situation, more money just causes buyers to bid against  
8 one another for a virtually fixed supply of goods and  
9 services. Prices, under these circumstances, can only  
10 go up.

11 35. The failure to distinguish between these two  
12 very different things leads to a false conception of the  
13 effects of "deficit financing" on the national economy.

14 36. Those who reject the idea of expansionary  
15 public policies are the victims of what has been aptly called  
16 "inflation psychosis". These people continued to have an  
17 obsession about inflation long after the signs became  
18 clear that those inflationary pressures which a central  
19 bank could help restrain had given way to inadequate growth  
20 and unemployment.

21 37. For some strange reason, the myth still per-  
22 sists in North America that unbalanced budgets will give  
23 rise to inflation under any and all economic circumstances.  
24 The fact that this has been disproved in practice so  
25 many times does not seem to have done much to dispel the myth  
26 For example, during the past four years overall price  
27 increases have been negligible in Canada, although during  
28 each of these years we incurred budget deficits. Indeed,  
29 between April 1, 1958 and April 1, 1959, the budget deficit  
30 came to the substantial sum of \$609 million. According



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37. For some strange reason, the myth still persists in North America that unbalanced budgets will give rise to inflation when in reality the opposite is true. The fact that this has been disproved in practice at many times does not seem to have done much to dispel the myth. For example, during the past four years overall price increases have been negligible in Canada, although during each of these years we incurred budget deficits. Indeed, between April 1, 1958 and April 1, 1959, the budget deficit came to the substantial sum of \$609 million. According



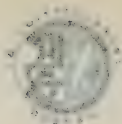


1 to those who believe that "budget deficits always bring  
2 inflation", this country should have been swamped by  
3 inflation. Yet the wholesale price index rose during  
4 the same period by only 1.4 per cent, and the consumer  
5 price index rose only 0.16 per cent, which probably was  
6 due to factors other than the deficit.

7 38. The situation was similar in the United States.  
8 For example, between June 30, 1958 and June 30, 1959, the  
9 United States experienced a sizable deficit of \$12.43  
10 billion. Again, according to the North American  
11 mythology, the U.S. should have been swimming in inflation.  
12 Instead, however, both consumer and wholesale prices rose  
13 by less than 1 per cent.

14 39. These, incidentally, were the years when  
15 "inflation psychosis" was especially rampant in financial  
16 and business circles in both countries. The dire pre-  
17 dictions about runaway inflation led to the usual outcries  
18 that we must have balanced budgets. Had government officials  
19 been foolish enough to reduce government expenditures  
20 to bring them into line with lagging revenues, the  
21 recession of 1958 would simply have worsened and lasted  
22 even longer.

23 40. The criticism which we have to offer with  
24 regard to the budget deficits of the last five years is  
25 that they were a significant degree involuntary. They  
26 resulted, at least at the beginning, because the slow  
27 pace of economic activity yielded less revenues than  
28 were required to balance expenditures. What was needed,  
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1 expanding national income and bringing about full employment.

2 We shall have more to say about this farther on.

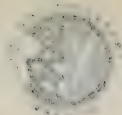
3 41. In both Canada and the United States, there  
4 are still many influential elements who regard a balanced  
5 budget (or even a budget surplus to retire the public debt)  
6 as an economic necessity even when the overall performance  
7 of the economy is inadequate to sustain full employment  
8 and adequate growth. The Congress, in its annual sub-  
9 missions to the Government of Canada, the Senate Committee  
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11 Conference on Unemployment, has repeatedly stated its  
12 opposition to such views. Indeed, we believe that the  
13 prevalence of these views has contributed significantly  
14 to the inadequate performance of our economy during the  
15 past few years.

16 42. It would seem that the Congress is not alone  
17 in challenging such views. American government officials,  
18 including President Kennedy, are now reported to be  
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20 ments to the use of national budgets to foster economic  
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24 " Two things about Western Europe appear  
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3 43. That European officials believe these two  
4 things to be closely related is borne out in a recent  
5 article in the New York Times (May 13, 1962, p. 24) which  
6 reports that the contrast between Western Europe in  
7 recent years, with its "remarkably successful economic  
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16 government budget policy (spending and taxation) and  
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18 "In the United States the financial actions  
19 of the Government, for varying reasons, have  
20 normally been designed to check demand --  
21 mainly through budget decisions aimed at a  
22 surplus and frequent use of 'tight money'.

23 Budget deficits have often occurred,  
24 despite original decisions aiming at a surplus,  
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Office of the  
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10 (France had budget deficits throughout the 1950's, including  
11 1960; the United Kingdom had deficits in every year from  
12 1951 through 1961; in four of the last five years, 1957-  
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#### Conclusion

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5 This fundamental difference has been at  
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7 my opinion and that of many others, it accounts  
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10 A Government official is reported as expressing  
11 "a common viewpoint":

12 " Quite frankly, I fear you will continue  
13 to do rather badly in the United States  
14 until you become more modern in the matter  
15 of the Federal budget and its use as an  
16 economic weapon. We have all learned the  
17 lesson in Europe some years ago. You never  
18 hear anyone talking about the 'national debt',  
19 for example. We approve of deficits, and they  
20 don't have to be inflationary.

21 If your Government had aimed at one or two  
22 sizable deficits at the right times over the  
23 past six years, instead of always trying to  
24 balance the budget and getting deficits by  
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A businessman is quoted as follows:



1 " Don't blame your troubles on automation.  
2 We have been investing in new machines in  
3 Europe faster than you have. The difference  
4 here is that Governments have pursued a  
5 policy of expansion, which means that demand  
6 has risen so fast and production with it  
7 that few people have been put out of work by  
8 mechanization. Those that have were able  
9 to find other jobs almost at once.

10 Demand is natural... It has risen here  
11 without interruption because our Governments  
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20 46. We have reported these comments because to  
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24 Speaking to an Ontario Federation of Labour Study Con-  
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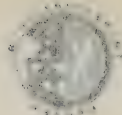
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1 "irrational, but it nevertheless exists. Now  
2 why does it exist? I think perhaps the first  
3 reason is that traditionally a Federal deficit  
4 has been associated with the idea of a dead-  
5 weight debt, and most people who borrow, who  
6 create assets, who build factories or equip-  
7 ment or schools or roads or hospitals, are  
8 able to see the physical consequence of their  
9 borrowing. In the case of the Federal  
10 Government, this is true only to a lesser de-  
11 gree; most of the Federal debt arose, of  
12 course, out of the war . . . . The assets  
13 which were on the other side cannot be  
14 measured or seen, although of course they are  
15 none the less valuable for that. In fact,  
16 to a degree, our national freedom is the asset  
17 on the other side, but you can't find it in a  
18 balance sheet. So for this reason people are  
19 generally inclined to regard a Federal deficit  
20 as a bad thing, and undesirable.

21 Now more specifically under conditions  
22 in the last few years in which to some extent  
23 we have pursued counter-cyclical fiscal policy,  
24 large deficits have come (in the minds of a  
25 large part of the public) to mean either  
26 inflation or high interest rates or both.  
27 Why should high interest rates result from  
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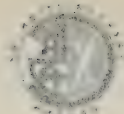


1 "in the general concept of Federal finance.

2 If one increases the supply of bonds offered  
3 by the Federal Government substantially,  
4 unless there is some off-setting factor to  
5 increase the demand, then of course as in  
6 the case of any other commodity, where you  
7 increase the supply very greatly you will  
8 drive down the price, that is the price of  
9 bonds, and drive up interest rates; and by  
10 and large this is the process which we have  
11 been going through periodically in recent years.

12 Now the people who are responsible, as  
13 I am, for large sums of money, which is  
14 primarily invested in bonds, and very  
15 frequently in government bonds, that is the  
16 insurance companies and the banks, the trust  
17 companies, individuals as well across the  
18 country, have come to fear that an increasing  
19 supply of bonds arising out of deficit finance  
20 would force interest rates higher. Therefore,  
21 in order to avoid the depressing effects  
22 which this would have upon their existing  
23 holdings, people hold back. They won't go  
24 far out into long term bonds; they are  
25 reluctant to do so, and the net effect is  
26 that it becomes increasingly difficult for  
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25 Now, as I say, these fears are not wholly  
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Washington, D.C.

A.23

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1 "logical fears can be reduced as much as  
2 possible. The irrationality of some of  
3 these fears can be readily shown in many ways.  
4 The deficits of the provincial governments in  
5 fact in recent years have been very much more  
6 substantial than those of the Federal Govern-  
7 ment, and yet very few people are concerned  
8 to anything like the same degree about the  
9 financing of the provincial governments.  
10 Why is this so? I think one reason is that  
11 the physical assets of the provinces can  
12 be seen -- that is, the results can be seen.  
13 The other is purely an accounting device --  
14 the fact that the provincial governments have  
15 two budgets, a current and a capital budget,  
16 which they separate. Their borrowings do  
17 not go into the current budget, and most of  
18 the provinces are able to show a surplus of  
19 a few million dollars a year in the current  
20 budget, when in fact they are borrowing one,  
21 two or three hundred millions a year.

22 The Federal Government does not have a  
23 capital budget in the same sense as the  
24 provinces do. Everything goes into the one  
25 budget; everything is current. All the capital  
26 assets, even where we are building airports  
27 and so forth, agriculture experimental sta-  
28 tions and so forth -- these all go into the  
29 current budget, so that a deficit of the  
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logical fears can be reduced as much as possible. The irrationality of some of these fears can be readily shown in many ways. The deficits of the provincial governments in fact in recent years have been very much more substantial than those of the Federal Government, and yet very few people are concerned to anything like the same degree about the financing of the provincial governments. Why is this so? I think one reason is that the physical assets of the provinces can be seen -- that is, the results can be seen. The other is purely an accounting device -- the fact that the provincial governments have two budgets, a current and a capital budget, which they separate. Their borrowings do not go into the current budget, and most of the provinces are able to show a surplus of a few million dollars a year in the current budget, when in fact they are borrowing one or two or three hundred millions a year. The Federal Government does not have a capital budget in the same sense as the provinces do. Everything goes into the one budget; everything is current. All the capital assets, even where we are building airports and so forth, agriculture experimental stations and so forth -- these all go into the current budget, so that a deficit of the Federal Government is a very different thing

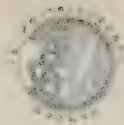


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3 five or thirty years ago, it was generally  
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6 the British converted their debt through a  
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9 around  $3\%$ , American rates at  $2\frac{1}{2}\%$ , and people  
10 then believed that not only were those rates  
11 justified at that time for that time, but  
12 forever. Now of course, people tend to  
13 believe the very opposite; that high interest  
14 rates are appropriate not only under the  
15 conditions of full employment and pressing  
16 inflation, but always. And this is the sort  
17 of psychological atmosphere in which we live  
18 and in which people tend to come to believe  
19 that what is true now must always be the case.  
20 Of course this isn't so.

21 Now I'd like to turn to the 'white side' --  
22 the other side of the moon which isn't looked  
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25 perfectly clear that a large part of our  
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8 ments; this also is intended. There are  
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20 In the United States, Mr. Paul Samuelson,  
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4 This could happen no matter how such government expendi-  
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9 50. To the extent that deficit financing merely  
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21 51. It is often contended that expansionary  
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23 Again the argument usually is based on the assumption  
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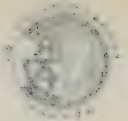


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2 52. Of course full employment policies would  
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24 Ironically, the deficit in the U.S. balance of payments,  
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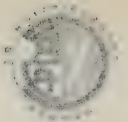
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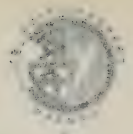
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sumers' inflation, that is to say, with effective consumer demand in excess of productive capacity. It was, instead, an investment inflation, brought on by excessive private capital spending. The central bank, however, is scarcely able to deal directly with corporate investments. This is because corporations draw largely on sources of capital which are virtually outside the central bank's control. These sources are internally generated savings (depreciation allowances and undistributed profits) and, to a lesser extent, the capital market.

63. According to a study made by the Bank of Nova Scotia (Monthly Review, September, 1956 -- "Financing a Decade of Corporate Investment"), in the ten year period, 1946-1955, total corporate investment in fixed capital goods and in inventories was \$24 billion. Three-fourths of this sum, or \$18 billion, resulted from internally generated savings. Depreciation allowances alone accounted for about 46 per cent of total capital funds. Only fiscal measures can deal with the principal source of private capital funds, internally generated savings.

64. While it is true that the central bank affects the capital market by its ability to influence interest rates, it is doubtful that an increase in interest rates has much effect in deterring corporations from raising capital during a boom. Interest rates are, for them, usually a negligible part of production costs. An increase in interest rates on corporate borrowing may be more than offset by the relatively easy profits to be made as prices go up during a boom. Furthermore,



summers' inflation, that is to say, with effective demand in excess of productive capacity. It was, indeed, an investment inflation, brought on by excessive private capital spending. The central bank, however, is scarcely able to deal directly with corporate investments. This is because corporations draw largely on sources of capital which are virtually outside the central bank's control. These sources are internally generated savings (depreciation allowances and undistributed profits) and, to a lesser extent, the capital market.

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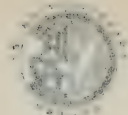




1 interest payments are deductible for tax purposes.  
2 65. It is true that the central bank, by reducing  
3 the money supply, and hence consumption, can produce  
4 some indirect effect in curbing investment inflation.  
5 But its action is relatively ineffective, because reduced  
6 consumption usually takes too long in affecting the  
7 investment intentions of corporations. By the time  
8 the effect is felt, the damage is likely to have been  
9 done.

10 66. While it is questionable, therefore, whether  
11 a tight money policy has any appreciable effect in  
12 restraining inflationary pressures caused by excessive  
13 corporate spending, it can have a significant effect  
14 on other economic groups who may not have any responsibility  
15 for generating inflationary pressures. An increase in  
16 long-term interest rates has a major effect on provincial  
17 and municipal governments, and other public bodies  
18 which raise loans in the capital market. Unlike  
19 corporations, they are not engaged in profit-making  
20 enterprises and thus cannot offset higher interest rates  
21 with higher profits. Furthermore, they are not endowed  
22 with the privileges of corporations that can offer a  
23 variety of capital instruments, such as common or  
24 preferred stocks, convertible debentures, commercial  
25 paper, and so on, which gives them a considerable  
26 advantage in competing for capital funds.

27 67. Public bodies are much more seriously affected  
28 by a tight money policy than private corporations.  
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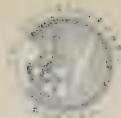
68. Another economic group who suffered during that tight money period were smaller businesses, who must invariably finance most of their needs through bank credit. Financial requirements of smaller businesses generally are not large enough to justify their raising loans in the capital market. When the central bank restricts bank credit, smaller businesses are among the first to be hurt.

69. Rising interest rates seriously discriminate against prospective home-builders. Even a comparatively small increase in the mortgage rate can be a significant addition to the total cost of building a home. The deterrent effect which this has on house-building will of course have repercussions elsewhere in the economy.

70. It would seem, then, that monetary policy intended to curb inflation caused by excessive private capital expenditures, especially by large corporations, makes no sense if its main effect is to curb economic activities not responsible for causing inflation, while leaving the rate of private capital expenditures comparatively untouched. Such policy slows down growth in economic sectors which need it, and leaves relatively unaffected those which should be retarded. The net result can only be unemployment and unbalanced economic development.

71. The answer to dealing with specific inflationary pressures is surely to use selective and not general monetary controls. If excessive private capital expenditures are generating inflationary pres-





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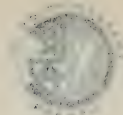


1       sures, then we should find ways and means of regulating  
2       these particular expenditures. We should also be  
3       careful in our choice of ways and means so as not  
4       to impair the long run economic incentives of the  
5       corporations themselves.

6       72.       What selective controls could be applied  
7       to restrain or prevent an investment inflation of  
8       the kind that took place in the period, 1955-1957?  
9       Since depreciation allowances are the principal  
10      single source of investment capital, they must be  
11      subject to public regulation if capital spending  
12      is to be effectively controlled.

13     73.       One method which may have distinct  
14     possibilities is a variable depreciation rate. The  
15     rate of depreciation that is deductible from corporate  
16     taxable income would be subject to change in accordance  
17     with economic conditions. For example, when an  
18     unhealthy boom threatened, the rate of depreciation  
19     allowances for tax purposes could be reduced accordingly.  
20     On the other hand, when economic activity showed signs  
21     of slowing down, the depreciation rate could be  
22     increased to provide the necessary incentive to invest.  
23     Increases and decreases in the depreciation rate would  
24     over the long run tend to balance each other, so  
25     that corporations should neither lose nor profit  
26     from the use of a variable depreciation rate.

27     74.       Another selective control which could  
28     help prevent investment inflation is the licensing of  
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1 exceeding a set value could be sold in the market.

2 Public regulation of capital issues, carried out  
3 through the Capital Issues Committee, has long been  
4 in effect in the United Kingdom.

5 75. Control over capital issues in this country  
6 might, of course, raise constitutional problems,  
7 since the Courts might hold that this matter falls  
8 under section 92, head 13 of the British North America  
9 Act, 1867, "property and civil rights in the province".  
10 Conceivably, the judges might be persuaded that such  
11 control is, under modern conditions, ancillary to  
12 control over "banks and banking", and therefore a  
13 legitimate exercise of the exclusive authority of  
14 Parliament over that subject. On the other hand,  
15 they might not be so persuaded. This would necessitate  
16 a constitutional amendment. We hope that, if you  
17 become convinced that control over capital issues is  
18 necessary, the admitted difficulties of amending the  
19 Constitution will not deter you from recommending such  
20 control.

21 76. The ability to regulate capital issues and  
22 to exercise some control over depreciation allowances  
23 would enable our public authorities to gain considerable  
24 regulatory power over the main sources of corporate  
25 investment funds.

26 77. It is very doubtful that general credit  
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5 nificant proportion of any moderate increase in the  
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7 78. Price increases may be caused by other factors  
8 which have nothing to do with excess demand. They may  
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11 reference to market supply and demand forces. They  
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13 investigations carried out under the Combines Investigation  
14 Act have proved. Recently certain concerns raised  
15 prices to take advantage of the devaluation of the dollar.  
16 We know that such factors as these can, and do, keep  
17 prices up, or rising, when effective demand is not  
18 exerting excessive pressure on supply.

19 79. This leads us to this conclusion: unless it is  
20 clearly discerned that price increases result from  
21 excessive demand on the nation's productive capacity,  
22 general credit restraint should not be imposed. To do so  
23 would only curb aggregate demand and bring on unemployment  
24 without checking price increases caused by factors  
25 other than excess demand.

#### 26 Influence of Central Bank on Interest Rates

27 80. We find it difficult to understand the Bank  
28 of Canada's policy on interest rates since 1956, at  
29 any rate until very recently. This policy has been  
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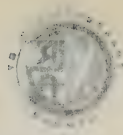
1 Report.

2 "The central bank, like other institu-  
3 tions operating in the capital market, buys  
4 and sells Government securities and bids  
5 for treasury bills at the weekly tender.  
6 These and other day-to-day operations of the  
7 Bank, including its lending to banks and  
8 money market dealers, have an influence  
9 on the level of interest rates, generally in  
10 the direction of resisting rather than inducing  
11 or adding to movements of interest rates.  
12 (underscoring ours). In other words the  
13 Bank will normally be buying government securities  
14 on a declining market and selling on a rising  
15 market.

16 In its day-to-day operations the Bank  
17 generally offers some resistance to changes  
18 in interest rates (in either direction) in  
19 the interests of maintaining orderly condi-  
20 tions in financial markets. However the  
21 Bank has always made it quite clear that  
22 the establishment or maintenance of any  
23 particular level of interest rates is not  
24 an objective of central bank policy" (pp. 48-49).

25  
26 81. This last statement is incorrect, because the  
27 Bank of Canada followed a deliberate policy in the early  
28 post-war period of supporting Government of Canada bond  
29 prices for the purpose of fostering low interest rates.

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1 does not accept the responsibility of giving some  
2 positive guidance and influence as to what the level  
3 of interest rates should be, is failing to fulfil one  
4 of its primary functions, the regulation of the cost of  
5 money in accordance with economic requirements. It is  
6 true that the effect of the central bank's operations  
7 in making changes in the money supply will be to exert  
8 some influence on interest rates. But a conscious policy  
9 to influence interest rates in accordance with economic  
10 requirements is surely needed in any modern economy.

11 83. It seems to us that there are good grounds for  
12 going even further, by suggesting that the Bank of  
13 Canada should consider adopting a regular policy of  
14 maintaining low long-term interest rates. The expansion  
15 of urban communities will require greater and greater  
16 sales of debentures and bonds by municipal and  
17 provincial governments. Public facilities and services  
18 of a wide range are expected to claim an increasingly  
19 larger proportion of national production. Better  
20 housing is required by a large part of the public. It  
21 is therefore in the general interest that these things  
22 be financed as cheaply as possible through low interest  
23 rates. High interest rates will only retard, or at  
24 least make very expensive, the meeting of these important  
25 public needs.

26 84. The Bank of Canada can maintain low interest  
27 rates by its support of Government bond prices, as it  
28 succeeded in doing in the earlier post-war period  
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1 cash reserves. But it would not, provided that the Bank  
2 of Canada used the power which was granted to it in 1954  
3 of changing the cash reserve requirements of the chartered  
4 banks if necessary. It could neutralize the effect on  
5 reserves by raising the cash reserve requirements of the  
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7 85. The power to vary the banks' reserve require-  
8 ments, which the Bank of Canada has never used, is  
9 important, then, in enabling the central bank to under-  
10 take appropriate action with respect to the bond market  
11 without necessarily increasing the money supply. There  
12 need be no conflict, therefore, between maintaining  
13 stable bond prices at low yields and, if necessary, at  
14 the same time preventing an unwise increase in cash re-  
15 serves. Moreover, with an expanding economy, the need  
16 for a gradually expanding money supply would probably  
17 require the infrequent use of this device.

18 The present statutory provision allows the  
19 Bank of Canada to vary the banks' cash reserve require-  
20 ments between 8 and 12 per cent of deposit liabilities,  
21 and within this range, the Bank is permitted to change  
22 the reserve requirement by 1 per cent at a time, after  
23 giving a month's notice. In order to provide the Bank  
24 of Canada with greater leverage, there would seem to be  
25 a good case for abolishing the legal limit of 12 per cent.  
26 The gradual change in reserve requirements, carried  
27 out at infrequent intervals and only after adequate  
28 notice had been given, would prevent any disruption  
29 of chartered bank activities.

30 86. We believe that a fixed Bank Rate would provide





cash reserves. But it would not, provided that the Bank of Canada used the power which was granted to it in 1937 of changing the cash reserve requirements of the chartered banks if necessary. It could neutralize the effect of reserves by raising the cash reserve requirements of the banks.

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The present statutory provision allows the Bank of Canada to vary the banks' cash reserve requirements between 3 and 12 per cent of deposit liabilities and within this range, the Bank is permitted to change the reserve requirement by 1 per cent at a time, after giving a month's notice. In order to provide the Bank of Canada with greater leverage, there would seem to be a good case for abolishing the legal limit of 12 per cent. The gradual change in reserve requirements, carried out at infrequent intervals and only after adequate notice had been given, would prevent any disruption of financial and business activities.

36. We believe that a fixed Bank Rate would provide



1 another useful supplement to open market operations by  
2 indicating the kind of monetary policy which the Bank  
3 believed appropriate at any given time. While it is true  
4 that the infrequent borrowings by the chartered banks  
5 from the Bank of Canada make a fixed Bank Rate a less  
6 effective tool of monetary policy in this country than,  
7 for example, in the United Kingdom, nevertheless, it  
8 could serve a useful purpose here. The Bank of Canada  
9 could use it to signal the kind of monetary policy it  
10 intended to implement. In this way, there would be a  
11 clear indication right at the outset of any intended  
12 change in monetary policy. The reaction to a change  
13 in Bank Rate, reinforced by appropriate open market  
14 operations, would speed up the implementation of any  
15 change in monetary policy. The method of allowing the  
16 discount rate to be set one quarter of 1 per cent above  
17 the average weekly Treasury bill yield makes the Bank  
18 Rate meaningless as an indication of the Bank's  
19 monetary policy.

#### 20 Control of Financial Intermediaries

21 37. We suspect that a major weakness in our  
22 financial system is the fact that financial intermediaries,  
23 or "near banks", are not subject to any kind of monetary  
24 control. They include such institutions as instalment  
25 finance companies, personal loan companies, trust and  
26 loan companies, and others. They appear to be exerting  
27 an increasingly strong influence on the economy, and they  
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Control of Monetary Institutions

7. We suggest that a major weakness in our financial system is the fact that financial intermediaries or "near banks", are not subject to any kind of monetary control. They include such institutions as insurance finance companies, personal loan companies, trust and loan companies, and others. They appear to be exerting an increasingly strong influence on the economy, and they constitute a formidable rival of the banks in monetary importance. Many students of monetary economics have





1 become increasingly aware of the fact that unless a  
2 measure of control over these institutions is co-ordinated  
3 with control over the banking system, monetary policy  
4 will become increasingly less effective.

5 88. Those who oppose bringing these institutions  
6 under monetary control argue that, unlike the banking  
7 system, they do not create credit. Hence, it is  
8 alleged, they do not influence the volume of the  
9 money supply, but serve as a medium between those who  
10 have savings to lend or deposit and those who desire  
11 to borrow. This is of course true. But this argument  
12 overlooks a very important fact. While financial  
13 intermediaries do not affect the volume of money, they  
14 probably have a significant influence on the velocity  
15 of money, and hence on prices and output. It seems  
16 to us, therefore, to make little sense that when the  
17 central banks is restraining bank credit, these  
18 institutions are not restrained from carrying on normal  
19 activities. Furthermore, there is nothing to prevent  
20 those holding money in current accounts in banks  
21 from switching into so called "near-money substitutes"  
22 of certain intermediaries to take advantage of rising  
23 interest rates during a tight money period. The  
24 highly liquid assets of some of these institutions make  
25 attractive investments, because they can be quickly  
26 converted back to cash.

27 89. What actual effect all this has on the velocity  
28 of money we are of course not in a position to know. But  
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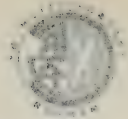


1 bank will become increasingly less effective. If this  
2 should prove to be the case, we would be particularly  
3 concerned lest the central bank, in order to make its  
4 tight money policy more effective against possible  
5 future inflationary pressures, should apply increasingly  
6 greater restraint on bank credit. We cannot help but  
7 feel that this has already happened on previous  
8 occasions when the Bank felt it necessary to apply a  
9 tight money policy. Had it had some way of restraining  
10 the activities of the non-banking financial institutions  
11 in the past, might it not have adopted a less stringent  
12 policy towards monetary expansion?

13 90. We are very much concerned about this whole matter  
14 because we believe that it can have an important bearing  
15 on employment. We believe that central banking operations  
16 have at times in the past been used to curb inflationary  
17 pressures over which the Bank did not have direct  
18 influence. This only contributes to unnecessary  
19 retardation of growth and to unemployment in sectors  
20 of the economy not responsible for generating inflation.  
21 That is why we have argued that more emphasis should be  
22 placed on selective rather than general controls.  
23 Bringing the non-banking financial intermediaries under  
24 central bank control would be a further step in this  
25 direction.

26 91. The former Governor of the Bank of Canada, Mr.  
27 James Coyne, in his Annual Report for 1956, pointed out  
28 the difficulty of carrying out an effective monetary  
29 policy with instalment finance companies operating  
30 entirely outside public regulation:





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policy with installment finance companies operating  
the difficulty of carrying out an effective monetary  
James Coyne, in his Annual Report for 1956, pointed out  
91. The former Governor of the Bank of Canada, Mr.  
central bank control would be a further step in this  
Bringing the non-banking financial intermediaries under  
placed on selective rather than general controls.  
That is why we have argued that more emphasis should be  
of the economy not responsible for generating inflation  
retardation of growth and to unemployment in sectors  
influence. This only contributes to unnecessary  
pressures over which the Bank did not have direct  
have at times in the past been used to curb inflationary  
on employment. We believe that central banking operations  
because we believe that it can have an important bearing  
90. We are very much concerned about this whole  
in the past, might it not have adopted a less stringent  
the activities of the non-banking financial institutions  
tight money policy. Had it had some way of restraining  
occasions when the Bank felt it necessary to apply a  
feel that this has already happened on previous  
greater restraint on bank credit. We cannot help but  
future inflationary pressures, should apply increasingly  
tight money policy more effective against possible  
concerned least the central bank, in order to make its  
should prove to be the case, we would be particularly  
bank will become increasingly less effective. If this



1 " The existence of what amounts to a rival  
2 banking system, competing for deposits and short-  
3 term funds in order to make short-term loans  
4 to finance consumption (and to an increasing  
5 extent the instalment finance companies also  
6 make loans to industrial contracting, trans-  
7 portation, merchandising and other businesses)  
8 without supervision or regulation, and out of  
9 step with the trend of credit policy in the  
10 regular banking system, can be a definite  
11 handicap to monetary policy during a boom, and  
12 will also have de-stabilizing effects during  
13 any recession of activity that may ensue"  
14 (p.27).

15 92. It would seem to us that the Bank of Canada  
16 should be empowered to regulate the activities of  
17 financial intermediaries. How this should be done is  
18 something that would require careful study. Perhaps  
19 one method for facilitating such control would be to  
20 require them to adopt reserve ratios which the Bank of  
21 Canada could vary as monetary conditions required.  
22 For example, if conditions required a certain restraint  
23 on the activities of these intermediaries, the Bank  
24 of Canada could raise the reserve requirement; if, on  
25 the other hand, easier credit conditions were required,  
26 the reserve requirement could be lowered. The raising  
27 of the reserve requirements would reduce velocity, while  
28 the lowering of reserve requirements would raise velocity.  
29 Although this is a matter of great complexity, its  
30 importance is such, we feel, as to warrant most careful



The existence of what amounts to a rival banking system, competing for deposits and short-term funds in order to make short-term loans to finance consumption (and to an increasing extent the installment finance companies also make loans to industrial contracting, transportation, merchandising and other businesses) without supervision or regulation, and out of step with the trend of credit policy in the regular banking system, can be a definite handicap to monetary policy during a boom, and will also have de-stabilizing effects during any recession of activity that may ensue."

(1937)

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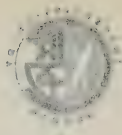


1 study.

2 93. Here, again, there may be a constitutional  
3 problem. The Courts might hold that some or all of the  
4 "financial intermediaries", except, of course, as to  
5 the interest they charged, and perhaps some other aspects  
6 of their affairs, came under "property and civil rights  
7 in the province". If so, it would, again, be necessary  
8 to amend the Constitution to vest control of such  
9 bodies in the Parliament of Canada. We reiterate our hope  
10 that, if you decide that control of the financial  
11 intermediaries is necessary, you will not hesitate to  
12 recommend such control and whatever constitutional  
13 amendment may be required.

14 94. Recent changes in exchange rate policy have  
15 particular significance for monetary policy. Indeed,  
16 the new policy of fixing the exchange rate will almost  
17 certainly have an important bearing on the kind of  
18 monetary policy the Bank of Canada can adopt. We are  
19 especially apprehensive that a fixed rate will make  
20 it difficult for Canada to pursue expansionary monetary  
21 and fiscal policies which are necessary to achieve  
22 full employment and suitable economic growth rates.

23 95. A free exchange rate, that is to say, a rate  
24 of exchange determined by the supply and demand for  
25 foreign exchange, is preferable for Canada with its  
26 comparatively large external transactions. Under such  
27 circumstances, a free rate is helpful in adjusting our  
28 balance of international payments to meet our domestic  
29 needs. However, with a fixed exchange rate, domestic  
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1 policies may well have to be adjusted to meet balance  
2 of payments requirements. This means that policies  
3 which may actually promote unemployment and low growth  
4 rates may be adopted because they are considered  
5 essential to the requirements of our balance of payments.

6 96. Indeed, the present balance of payments  
7 problem underlines the need for a free exchange rate for  
8 Canada. We believe that with a free rate, together with  
9 positive policies to stimulate exports of goods and  
10 services, our present external difficulties could be  
11 greatly reduced and there would be no need to employ  
12 either external or internal policies of a restrictive  
13 type.

14 97. The Congress reluctantly recognizes the need  
15 for the present emergency import restrictions, but  
16 they are essentially negative and should be regarded  
17 as temporary. We believe that it would be most unwise  
18 to think of these restrictions as a long-term solution.  
19 It is here where we part company with those who believe  
20 that Canada's external deficits can best be cured by  
21 a regular policy of restricting imports into this country.

22 98. We believe that any attempt to make the present  
23 emergency surcharges on imports permanent, or to  
24 implement any other long-term import restrictions, would  
25 only result in harmful price increases in our economy.  
26 Further devaluation of our dollar would do the same.  
27 Increased costs might have a serious effect on our  
28 ability to export, and we should thus be no nearer,  
29 perhaps even farther off from, solving our balance of  
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1 99. Furthermore, such restrictive measures are out  
2 of step with today's need for substantial liberalization  
3 of world trade. They are out of step with the virtually  
4 revolutionary tariff changes which the Kennedy  
5 administration is attempting to bring about between  
6 North America and Western Europe. The inescapable fact  
7 is that the traditional method of using severe restrictive  
8 external measures to cure a balance of payments problem  
9 is no longer tenable in a world which is seeking to  
10 expand trade. Any important trading nation which adopts  
11 such a cure will affect somebody else's balance of pay-  
12 ments. For example, while the U.S. appreciates why  
13 Canada has recently imposed surcharges on a wide range  
14 of imports, she is nevertheless concerned that such  
15 restrictions must inevitably aggravate her own balance  
16 of payments problem. It is therefore imperative that  
17 nations seek more positive means in dealing with external  
18 deficits.

19 100. Many Canadians have been led to believe that  
20 deficits in our transactions with the outside world  
21 are chiefly, if not wholly, the result of a serious  
22 imbalance in merchandise trade. Perhaps this is  
23 because figures on our current account transactions with  
24 the rest of the world are sometimes reported loosely  
25 in the press. Such misunderstanding on the part of the  
26 public is undoubtedly the reason why so many over-  
27 dimplify the problem, and why it leads them to urge,  
28 among other things, restrictions on merchandise imports  
29 to bring them into line with exports.

30 101. Beyond question, however, Canada cannot continue



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1 indefinitely to incur large annual deficits on current  
2 account, certainly not without offsetting net capital in-  
3 flows. Nor can we borrow indefinitely from the IMF  
4 and other international financial institutions to  
5 replenish our exchange reserves. Without some positive  
6 programme over the long-run, this country could be  
7 faced with frequent serious financial crises.

8 102. It would appear that somehow we are going  
9 to have to increase our exports of goods in order to  
10 compensate for certain recurring deficits on "invisibles",  
11 such as the deficit on dividend and interest payments.  
12 (Last year the deficit on the latter was 57.1 per cent  
13 of the total deficit. Preliminary figures, D.B.S.)

14 103. For years the United States has exported  
15 substantially more goods than she has imported, which  
16 has helped to offset deficits in non-merchandise  
17 transactions. (Even with large favourable balances  
18 of trade, deficits on "invisibles" continue to leave  
19 her with significant overall deficits). It would appear  
20 that Canada is going to have to do the same if she is  
21 to offset her large deficits on "invisibles". We  
22 suggest, therefore, that careful consideration be given  
23 to adopting the most effective possible measures to  
24 boost merchandise exports. For example, export sub-  
25 sidies might be one such measure. A further improvement  
26 in export credit facilities might be another. Tax  
27 incentives to firms which exceed certain export quotas  
28 might still be another.

29 104. Some may object that some of these measures  
30



104. Some may object that some of these measures might still be another. Incentives to firms which exceed certain export quotas in export credit facilities might be another. Tax aids might be one such measure. A further improvement boost merchandise exports. For example, export subsidies might be one such measure. A further improvement to adopting the most effective possible measures to suggest, therefore, that careful consideration be given to offset her large deficits on "invisibles". We that Canada is going to have to do the same if she is her with significant overall deficits). It would appear of trade, deficits on "invisibles" continue to leave transactions. (Even with large favourable balances has helped to offset deficits in non-merchandise substantially more goods than she has imported, which 105. For years the United States has exported of the total deficit. Preliminary figures, D.B.S.) (Last year the deficit on the latter was 57.1 per cent such as the deficit on dividend and interest payments, to have to increase our exports of goods in order to 106. It would appear that somehow we are going faced with frequent serious financial crises. programme over the long-run, this country could be and other international financial institutions to flows. Now can we borrow indefinitely from the IMF account, certainly not without effecting net capital



1 will not meet with the approval of nations competing  
2 with us in international trade. Be that as it may, other  
3 countries, especially those favoured with surpluses in  
4 their external accounts can have little justification  
5 for opposing essentially positive measures by deficit  
6 countries. Such measures are surely preferable to  
7 the adoption of higher tariffs or other import  
8 restrictions, with their contracting effect on trade.

9 105. There may also have to be important changes  
10 in the structure of some of our secondary industries.  
11 In some cases there are too many firms operating in a  
12 comparatively small Canadian market, which only results  
13 in unnecessary inefficiencies. The time may be at hand  
14 when a certain streamlining of our industries may be  
15 essential, if not indispensable, to enable us to better  
16 compete with larger foreign industrial units.

17 106. We believe that there is a good deal of room  
18 for improvement in the Canadian tourist industry. While  
19 Canada is not endowed with a Palm Beach or a Riviera,  
20 she is far from being devoid of attractive natural tourist  
21 spots. What is needed is a major programme by the Federal  
22 and Provincial Governments to give all possible assistance  
23 in developing our natural sites and in disseminating  
24 information to attract foreign tourists to Canada, as  
25 well as encouraging Canadian tourists to do more of their  
26 travelling inside Canada.

27 107. However, while we believe that measures such as  
28 these are needed to increase our exports of goods and  
29 services, we are still doubtful that Canada can avoid  
30 serious balance of payments problems in the future with a





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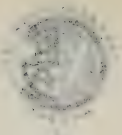
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1 fixed exchange rate. We realize of course that members  
2 of the International Monetary Fund are obligated under the  
3 Fund's agreement to fix their exchange rates. It is our  
4 view, therefore, that Canada should seek either outright  
5 repeal of this provision to enable countries like ours  
6 to adopt a free exchange rate with its "self-correcting"  
7 mechanism, or, at the very least, an amendment allowing  
8 exchange rates to fluctuate within appreciably wider  
9 limits. Otherwise, we are apprehensive that fiscal  
10 and monetary policies in Canada may have to be used  
11 in the first instance to support the country's exchange  
12 rate rather than serve primarily the goals of greater  
13 employment and output. Should this prove to be the  
14 case, the Canadian economy may well enter a long period  
15 of stagnation, with unprecedented post-war rates of  
16 unemployment.

17 108. The best exchange rate policy for Canada,  
18 we submit, is to get back to the floating rate. The  
19 next best is to get the International Monetary Fund  
20 rules changed to allow the fixed rate more flexibility.  
21 If this country can neither get back to a floating  
22 rate, nor get a more flexible fixed rate, then, we  
23 submit, it will have to press, and press hard, for new  
24 international monetary arrangements which will provide  
25 for a far greater degree of international liquidity than  
26 now exists. For countries which have a fixed exchange  
27 rate, this is a problem which is becoming increasingly  
28 important, and which will have to be attended to before  
29 long. We are referring to the increasing difficulties  
30 besetting the international monetary system. The supply



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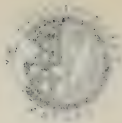


1 of international monetary reserves has not been keeping  
2 pace with the growing credit requirements of international  
3 trade and investment. This has been well documented by  
4 a number of international monetary authorities, and in  
5 particular by Professor Robert Triffin of Yale University,  
6 internationally recognized as a foremost expert on  
7 international monetary questions. Triffin points out that:

8 "...gold has long ceased to provide an  
9 adequate supply of international liquidity  
10 for an expanding world economy. More than  
11 half of the world's liquidity requirements  
12 have been derived in recent years from the  
13 enormous growth of foreign exchange reserves,  
14 and particularly of dollar balances, along-  
15 side of gold itself. The implications of  
16 this trend for the future stability of the  
17 world monetary system are, however,  
18 extremely disquieting." (Gold and the Dollar  
19 Crisis, Robert Triffin, Yale University  
20 Press: 1961, p. 54).

21 109. The system whereby nations have been holding  
22 a considerable proportion of their international  
23 reserves in the form of foreign exchange, and especially  
24 in dollar claims, is beginning to break down.

25 110. Other nations have been greatly aided in  
26 building up their foreign exchange reserves as a result  
27 of large deficits in the American balance of payments.  
28 It is widely agreed that this worked reasonably well  
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1 short. The unusual method whereby European Central Banks  
2 permitted the Americans to settle their international  
3 accounts largely by paying dollars instead of by the  
4 usual payment in gold meant that there could be considerable  
5 economy in the use of gold for monetary purposes.

6 111. However, it has become apparent that the  
7 Americans cannot continue indefinitely piling up external  
8 deficits and settling them in dollars. As continued  
9 deficits in the U.S. balance of payments have resulted  
10 in increases in foreign holdings of dollars, and hence  
11 in potential claims on the American gold reserves, there  
12 has been a sharp decline of confidence in the American  
13 dollar. In recent years this has caused an outflow of  
14 gold of such proportions as to cause American authorities  
15 to become seriously concerned.

16 112. The Congress recognizes that Canada alone  
17 cannot change the present, inadequate international  
18 liquidity arrangements. But we suggest that, if you feel  
19 unable to recommend either outright return to a floating  
20 exchange rate, or a more flexible fixed rate, then it  
21 becomes imperative for you to consider carefully what  
22 policy Canada should adopt towards the various plans  
23 for greater international liquidity, and to make  
24 recommendations accordingly. Such recommendations could  
25 then serve as a basis for Canadian proposals in the  
26 international negotiations on this subject which cannot  
27 be much longer postponed.

28 113. We come finally to the question of changes in  
29 the Bank of Canada Act and in the way the Bank functions.

30 On the whole, we think the Act itself is





On the whole, we think the Act itself is the Bank of Canada Act and in the way the Bank functions. We come finally to the question of changes in international negotiations on this subject which cannot then serve as a basis for Canadian proposals in the recommendations accordingly. Such recommendations could for greater international liquidity, and to make policy Canada should adopt towards the various plans becomes imperative for you to consider carefully what exchange rate, or a more flexible fixed rate, then it unable to recommend either outright return to a floating liquidity arrangements. But we suggest that, if you feel cannot make any recommendation, that is, that the Act should be to become seriously concerned.

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adequate. We have, however, six specific changes to suggest:

- (a) The preamble to the Act should be amended by inserting, after the words "production, trade, prices and employment", in the sixth line, the words, "and to promote full employment". This would make clear, beyond shadow of doubt, that full employment (not simply mitigating fluctuations in the general level of employment) is one of the major objectives of national policy in general and of national monetary policy in particular.
- (b) Section 6 (3) (a) should be amended to make clear the precise procedure to be followed in removing the Governor or Deputy Governor, so as to preclude the repetition of what went on a year ago when the Government, in order to remove the then Governor, felt that it had to resort to an amending Bill declaring the office vacant. If it is considered necessary to place the Governor and Deputy Governor beyond the reach of dismissal by the Government of the day, proprio motu, then we suggest that the paragraph should be amended by adding the words, "but may be removed from office at any time by the Governor General, on Address of the Senate and House of Commons". This would place the Governor and Deputy Governor in the same position as Judges of the Superior Courts, the Auditor-General, the Chief Electoral Officer, the Civil Service Commissioners, the Transport Commissioners, the



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1 members of the Board of Broadcast Governors, the  
2 members of the National Energy Board, and the  
3 Directors of the Canadian Broadcasting Corporation  
4 (except the President and Vice-President). On  
5 the other hand, if it is felt that the Governor and  
6 Deputy Governor should not be placed in so  
7 independent a position, then the paragraph might  
8 be amended by adding the words, "but may be  
9 removed for cause at any time by the Governor in  
10 Council". This would place the Governor and  
11 Deputy Governor in the same position as the  
12 members of the Tariff Board, the Wheat Board and  
13 the Canadian Pension Commission, and the President and  
14 Vice-President of the Canadian Broadcasting  
15 Corporation. Or the Act might borrow from  
16 section 62 (2) of the Bank Act, which provides that  
17 the Inspector-General of Banks shall hold office  
18 during good behaviour, but may be removed by the  
19 Governor in Council "for misbehaviour or incapacity,  
20 inability or failure to perform his duties properly".  
21 (c) Steps should be taken to make the Board of Directors  
22 really effective, which it does not appear to be now.  
23 It should function in roughly the same way as the  
24 Court of Directors of the Bank of England. This  
25 change may not require any amendment to the Act,  
26 though we think it should be specified, in section  
27 10 (1) that a due proportion of the Directors should  
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- 2 (d) The Act should distinctly provide, as the British
- 3 Act does, that the final responsibility for monetary
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- 5 would preclude repetition of the performance, in
- 6 which both Liberal and Conservative Ministers
- 7 have indulged, of disclaiming responsibility for
- 8 monetary policy. It is, as the present Government
- 9 ultimately decided, intolerable that the Bank of
- 10 Canada should constitute an imperium in imperio,
- 11 an independent, sovereign power, pursuing a policy
- 12 the direct opposite of the Government's own fiscal
- 13 policy; and the language of the Act should be such
- 14 as to make it impossible for any future Minister
- 15 to talk nonsense on this point. It is hardly
- 16 necessary to add that the Congress does not want
- 17 to see the Bank become a department of the govern-
- 18 ment, or the plaything of partisans. We are just
- 19 as anxious as anyone else to keep the management
- 20 of the Bank in competent hands, and to free it
- 21 from day-to-day political independence in high
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- 24 (e) The Auditor-General should be designated as the
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Political Science, Vol. XXVII, no. 1, Feb. 1961,  
pp. 1-22):

" It may be argued that if the government controlled the Bank of Canada it could make special financial deals for political purposes. If we assume, however, that the Bank of Canada as it is now constituted never makes special deals of a questionable nature we may be assuming too much. If the Bank of Canada were to engage in such a transaction, it would probably never see the light of day. But if the Bank were a department, or the Auditor General were designated as the Bank's auditor, which he is not, any irregularities of this nature would find their way into the Auditor General's report and would thus be opened to the scrutiny of Parliament and the general public. The independence of the Bank of Canada from the Auditor General does not guarantee the integrity or impartiality of the Bank's practices nearly as much as it guarantees their secrecy. It has often been suggested that central banking activities must be shrouded in secrecy (and kept hidden for many years after the event) if central banks are to do their work effectively, but this is merely a myth that has been perpetuated by the sub-culture of the financial world, and by the Bank of England in particular. Finan-



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(f) The Bank of Canada Act should itself provide for periodic, and fairly frequent, revision. The Bank Act, in effect, provides for its own revision every ten years. We are inclined to think that, in a world of increasingly rapid economic change, both Acts should be subject to revision at more frequent intervals. This would, incidentally, provide more ample, and frequent, opportunities for public education in the subjects concerned, through the hearings which would take place either before a Royal Commission or a Parliamentary Committee.

114. More important than any changes in the Bank of Canada Act itself, however, is the spirit in which, and the purposes for which, it is used. The late Professor Stefan Stykolt, of the University of Toronto, in a speech to the same Ontario Federation of Labour Study Conference on Unemployment from whose Report we have already quoted, laid down certain principles which appear to the Congress to be both indispensable and



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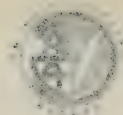


1 and incontrovertible:

2 " One of the main tools which can be used  
3 in the task of creating new jobs is a positive  
4 monetary policy. Monetary policy is the  
5 government's policy which determines the  
6 size, availability and cost of credit in  
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11 Monetary policy must be part of the  
12 democratic process. This means that the  
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15 Parliament for the conduct of monetary policy,  
16 for its goals and its methods. He must be  
17 prepared to explain it candidly, defend it  
18 against criticism, declare his confidence in  
19 the institutions and in the individuals who  
20 manage it and participate in its formulation  
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22 monetary policy, like defence policy or  
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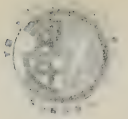
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2 Positive monetary policy must be con-  
3 sistent. The goal which monetary policy pur-  
4 sues at any moment must be clear first of  
5 all to the officials who implement policy,  
6 secondly to those who bear the brunt of  
7 policy in the first instance, that is to  
8 the entire financial community, and thirdly,  
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12 mystifying statements .....

13 .....The authorities' intentions must be  
14 clear, unequivocal and unambiguous to all  
15 concerned. At any one time all the signals  
16 by which the course of monetary policy is  
17 made manifest to the financial markets  
18 and to the public at large must point in  
19 the same direction. For only then can the  
20 individuals and institutions whose co-  
21 operation is essential if monetary policy is  
22 to be effective in attaining its goal ...  
23 play their proper part. Specifically, the  
24 movements in the stock of money, the changes  
25 in the discount rate, and the speeches of  
26 the Minister of Finance and of the officials  
27 of the Bank of Canada must all tell the same  
28 story. If they do not the result is sullen  
29 confusion in financial markets which makes  
30 monetary policy ineffective, if policy can be



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1 "said to exist when conflicts in its goals  
2 remain unresolved. Consistency requires  
3 also that the goal of monetary policy be  
4 altered only in response to an evident  
5 change in the country's economic conditions.  
6 If the country moves from a period of very  
7 high employment and inflation to a period  
8 of very high unemployment and price stability  
9 the goal of policy must change from re-  
10 stricting the level of economic activity to  
11 increasing it by every means well-known to  
12 professional students of the subject. But  
13 the goal of policy cannot shift about from  
14 week to week or month to month without any  
15 objective change in the country's economic  
16 conditions. Inexplicable and violent  
17 fluctuations in the goal of policy are  
18 demoralizing and blunt the instrument at a  
19 time when it may be needed most .....

20 Finally, monetary policy must be consistent  
21 with that other branch of economic policy  
22 designed primarily to attain a high and  
23 stable level of employment and of prices,  
24 namely fiscal policy. In periods of  
25 depression, budgetary deficits must be  
26 financed with the help of monetary expansion.  
27 In periods of inflation, budgetary surpluses  
28 may be used to bring about monetary restraint."

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Nethercut & Young  
Toronto, Ontario

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2 Respectfully submitted on behalf of the  
3 CANADIAN LABOUR CONGRESS,  
4

5 Claude Jodoin, President

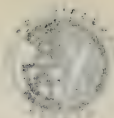
Donald MacDonald, Secretary-  
Treasurer

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9 William Dodge, Executive  
10 Vice-President

J. Morris, Executive  
Vice-President

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